IMPACT OF UNDERFUNDED DEFINED-BENEFIT PENSION PLANS ON THE FEDERAL DEFICIT, PLAN RETIREES, AND PLAN SPONSORS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

FEBRUARY 4, 1993

Serial 103–4

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IMPACT OF UNDERFUNDED DEFINED-BENEFIT PENSION PLANS ON THE FEDERAL DEFICIT, PLAN RETIREES, AND PLAN SPONSORS

THURSDAY, FEBRUARY 4, 1993

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:10 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
THURSDAY, JANUARY 14, 1993

PRESS RELEASE #1
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A PUBLIC HEARING TO REVIEW THE
IMPACT OF UNDERFUNDED DEFINED-BENEFIT PENSION
PLANS ON THE FEDERAL DEFICIT, PLAN RETIREES, AND PLAN SPONSORS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing to review the impact of underfunded defined-benefit pension plans on the financial condition of the Pension Benefit Guaranty Corporation (PBGC), retirees covered by Federally-insured pension plans, and the sponsors of such plans. The hearing has been scheduled for Thursday, February 4, 1993, beginning at 9:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.

In announcing this hearing, Chairman Pickle stated: "The PBGC, which was intended to be a self-financing Federal corporation insuring defined-benefit pension plans, currently has assets of only $5.7 billion to cover liabilities of $8.2 billion. Further, information recently released by the PBGC and the General Accounting Office (GAO) indicates that the financial condition of the defined-benefit pension system is continuing to deteriorate. In addition, the PBGC is reasonably likely to become responsible for an additional $13 billion in unfunded pension benefits in connection with plans that are likely to, but have not yet, terminated. Total unfunded liabilities in defined-benefit plans, for which the PBGC could become responsible, now exceeds $40 billion. These numbers are up sharply from just a few years ago. In the past year, the PBGC's exposure increased by $10 billion, and information on the 50 largest underfunded plans indicates that plan underfunding is continuing to increase rapidly. Unless Congress and the Administration act now, these problems will worsen, and this country's pension-guarantee program will become the next savings and loan bailout.

"These problems are, in part, the result of insufficient Federal minimum pension funding requirements, inadequate PBGC insurance premium charges for underfunded plans, and a method of measuring PBGC's budget that masks the agency's exposure to future claims. At a time in which the Federal Government is facing a serious budget deficit, it is irresponsible to continue to allow a few companies to run-up tens of billions of dollars in potential claims against the American taxpayer by shirking their responsibility to properly fund their pension promises. Unfortunately, that is exactly what is happening.

"Further, it is not enough to just assume that companies sponsoring fully funded plans will be willing to pay ever increasing premiums to cover the failures of those who choose to underfund their pension plans. Nor is there any reason to assume that this problem will go away on its own. The hard truth is that it is up to us to make changes now to correct this situation. The very least we can do is to stop this problem from getting worse.

"In taking these actions, we must recognize that when an underfunded pension plan fails it is not only the PBGC which bears the cost. A plan failure often represents a real hardship for the retirees covered under that plan. In many cases plan participants suffer a dramatic loss of income at a time, late in their lives, when they are unable to find other employment. In addition, plan participants are often faced with years of uncertainty and significant legal expenses while they wait for the Federal bankruptcy process to resolve other creditors' claims against their pension plan's sponsor.

These and other problems for participants could be avoided if pension plan sponsors properly funded their pension promises. And yet, nearly 20 years after the passage of the Employee Retirement Income Security Act, some plan sponsors continue to deliberately underfund their defined-benefit plans, putting their employees and taxpayers at economic risk."

The Subcommittee will receive testimony from representatives of the PBGC, the Congressional Budget Office (CBO), the GAO, and retirees who participated in various failed pension plans which were terminated without sufficient assets. The PBGC will testify on the extent of current financial problems confronting the agency, the effectiveness of its efforts to control its exposure to claims by underfunded pension plans, and its efforts to mitigate the effect of plan underfunding on plan participants. The CBO will testify concerning the extent of the losses experienced by the PBGC and the inability of the agency to measure, control, and offset these losses, and other budget matters. The GAO will testify on its recently released reports indicating that underfunded defined-benefit pension plans have significant hidden liabilities which increase claims against the Federal pension insurance program, and identifying the PBGC as one of 17 "high risk" Federal program areas in which corrective action is essential to the safeguarding of scarce Federal resources.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Thursday, March 4, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

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****** NOTICE -- CHANGE IN TIME ******

FOR IMMEDIATE RELEASE
MONDAY, FEBRUARY 1, 1993

PRESS RELEASE #1-REVISED
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCE A CHANGE IN TIME FOR THE PUBLIC HEARING TO REVIEW THE IMPACT OF UNDERFUNDED DEFINED-BENEFIT PENSION PLANS ON THE FEDERAL DEFICIT, PLAN RETIREES, AND PLAN SPONSORS

The Honorable J. J. Pickle (D., Texas), Chairman, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today the time of the public hearing to review the impact of underfunded defined-benefit pension plans on the financial condition of the Pension Benefit Guaranty Corporation scheduled for Thursday, February 4, 1993, has been changed <u>from 9:00 a.m. to 10:00 a.m.</u>, in the main Committee hearing room, 1100 Longworth House Office Building.

All other details of the hearing remain the same (see Press Release #1, dated Thursday, January 14, 1993).

Chairman PICKLE. The subcommittee will please come to order.

I want to apologize to my colleagues and to the panelists for being just a few minutes late. Some of us attended the prayer breakfast this morning and there was more sermonizing than there was prayer at times. So we are running a little late. Thank you for your indulgence.

This is an important hearing this morning. I hope we can proceed with dispatch and keep moving along as much as we can.

The Oversight Subcommittee is meeting this morning to consider the very severe problems confronting the Pension Benefit Guaranty Corporation and the defined-benefit pension system which provide retirement security for over 40 million workers. This is the third hearing held by this subcommittee on this subject in the past 6 months. I fully expect that we will hold additional hearings on this subject in the near future.

We are holding these hearings because of the financial instability of the PBGC and the resulting liabilities which may be borne by workers and the American taxpayers. The PBGC had a deficit of $2.7 billion by the end of 1992, and as a result of past pension plan failures, that deficit is still there. If that is not enough cause for worry, the total level of pension underfunding for which the Federal Government is potentially liable has now reached $51 billion, up from $30 billion only 2 years ago.

We all have some responsibility for the current situation. Under current law, certain companies have been allowed to and have chosen to seriously underfund their pension plans. Some plans, with underfunding of billions of dollars, have continued to make expensive pension promises that they may never keep. Some plans have used up all their assets knowing that, upon termination, the Federal Government will become responsible for their promises. Some labor unions and the collective bargaining process have failed to ensure that pension promises are fully and properly kept. Clearly, current Federal law has proven inadequate. It is time for companies sponsoring pension plans, the American worker, the Congress, and the administration to assume responsibility for the current situation and work together to meet our obligations.

The question is: Will we fix it or will we bury our heads in the sand? I do not know what the Congress will do. We do not have any set plans specifically saying we are going to do specific things. There are those who are content with the status quo. They are willing to let companies go on promising benefits regardless of a company's ability to pay for them. They know that in the end the Federal Government will be forced to stand behind these otherwise empty promises. They are not troubled that American workers who have no pensions and no health benefits may be forced to pay higher taxes to bail out some of the largest companies in our country. They say "Don't worry. PBGC has enough cash on hand to pay benefits for another 10 years or so before it will be completely bankrupt. So let somebody else worry about the PBGC when its their problem." My concern is that this is the same old dodge that was used before when we were forced to bail out the railroad unemployment system, the farm credit system, the bank insurance system and yes, the savings and loan system. I think the American people are tired of that.

Those of us who care about addressing these issues are accused of "frightening the elderly and scaring the workers." I personally reject these charges. I have never said that the PBGC will fail to honor its obligations. I have never even hinted that a retiree should worry about whether they will get what they are entitled to under the law. To the contrary, I firmly believe that the Federal Government will keep its commitment to retirees. But, unless we act now to force companies to accept their responsibilities and honor their commitments, the Federal Government will be forced to raise the money to keep these commitments later. Inevitably, companies that have behaved responsibly will pay for this bailout. I don't believe either of these choices is fair.

I believe that allowing a minority of companies to seriously underfund their pension plans is bad pension policy, bad industrial policy, bad tax policy, and bad social policy. It ought to be stopped immediately. Past underfunding ought to be paid up as quickly as possible. Companies ought not to go on treating their pension funds as if they were a private bank. The IRS doesn't let companies skip out on their taxes just because paying them is inconvenient. On payday, workers don't let companies shortchange their paychecks just because the companies see a better business opportunity elsewhere. Banks don't let companies take a pass on their loan obligations just because the company might want to pay a higher dividend to its shareholders. But due to the flexibility of pension laws, some companies have decided to pick and choose when they will fund their pension promises and in far too many cases they never pay it at all. These companies abandon their pension promises on Treasury's doorstep.

Earlier this year, I reintroduced a bill that I had originally introduced last year which would hold companies accountable when they sponsor an underfunded pension plan. The bill would require that: One, plans fund or collateralize at least 90 percent of their current benefits before granting additional benefits; two, underfunded plans, at a minimum, contribute to the plan each year an amount that equals distributions from the plan, plus interest on the plan's unfunded liabilities; and three, PBGC be given access to needed information on the plans that it insures.

With the bipartisan support of my colleagues on this subcommittee and in the full committee, I intend to advance legislation as expeditiously as possible along those appropriate lines. I urge those who find technical fault with this approach to suggest alternatives. It is to learn more about the problems and possible solutions that we meet today. But I also urge those who share my interest in seeing that American workers continue to be protected by strong pension systems to come together and to work now on this pressing problem. There is no advantage to further delay.

That concludes my statement. I recognize it was a little long, but I wanted to cover as much of the subject as I could.

I yield to Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman. Just a few comments.

This is a very timely hearing because several factors are important. First of all, there is a financial overhang. Many times it is behind the curtain. People don't know about it. We saw it in the savings and loan experience.

We don't know the full story about the Pension Benefit Guaranty Corporation, but we want to find out. The pension system has enormous impact on American businesses far beyond just pensions themselves.

Thirdly, critically, people depend upon the PBGC and corporations to do something fair, and maybe the systems under which they are operating are not good.

We looked at high-risk areas yesterday. It was very sobering, very interesting. Today we are going to look at the pension system. Clearly it is not uniform.

Some businesses deliberately try to fund or overfund their system. Others through a matter of practice that are totally self-sufficient and very financially sound, deliberately underfund their system.

What does that mean? What does it mean to the individuals who depend upon that, ultimately? Mr. Chairman, you have done a wonderful job. Although I have only recently been exposed to H.R. 298 in terms of learning some of the details, it presents a general corporate guideline about how we should address this issue.

This hearing will establish the groundwork for making progress. I am delighted to be here.

Thank you, Mr. Clarke, and the other panel members, and I will relinquish the remaining part of my time.

Chairman PICKLE. Does any other Member want to make an opening statement?

Mr. Kleczka.

Mr. KLECZKA. Let me thank you.

As a new member of the subcommittee, I am pleased to be associated with you and the work of this panel to protect the best interests of the public. Your foresight in calling for a review of the Pension Benefit Guaranty Corporation is most timely.

While workers and pensioners in the United States should not panic today because of increased scrutiny of the PBGC by this panel, it is appropriate that we point out the massive fiscal problems that loom ahead.

The growing trend of increasing long-term liabilities to the pension guaranty agency are cause for concern. While today the current cash flow of PBGC is positive, the growing liabilities due to underfunding of plans is still a debt that will come due.

Underfunding is quickly and steadily rising. From 1981 to 1991, this debt increased from $40 to $51 billion. About one-fourth of this amount, over $12 billion, is underfunding from financially troubled companies.

As you look at what type of companies they are, they are basically in the auto industry, the airline industry, and the steel industry. That is where the payout is.

As for payouts, last year PBGC paid $636 million in benefits to 150,000 participants, a 23 percent increase over the 1991 payments.

There is also a backlog or waiting list of 170,000 workers who have not yet retired, but whose plans have been taken over by the PBGC. It is certain there will be increased demands by PBGC as workers with defined benefit plans enter retirement.

It is understandable that some, like myself, draw parallels between PBGC status and the ongoing savings and loan mess. While

there are important differences, such as the fact that total pension benefits need not be immediately funded due to annual payouts, it is important that Congress start asking questions now rather than taxpayers demanding answers later.

Premiums are the primary revenue base for pension insurance, but costs outweigh premium income each year. There is already a $2.7 billion deficit.

Perhaps the premium structure deserves another look. The feasibility of any changes should be thoroughly discussed, and I hope our witnesses today will offer their views on the premium structure.

Another component of the underfunding problem lies in the pension laws funding requirements. Although pensions are long-term obligations, the law provides flexibility in annual funding requirements. What we need to determine is whether we have the right amount of flexibility to encourage maintenance of good pension plans or if there is too much flexibility which adds to risk.

Most important however is the impact of pension insurance on the pensioner himself. An employee's pension represents a lifetime of work and commitment. Uncertainty about the safety of pension promises during a termination can be traumatic for the worker and their family. An employee can be shocked and disappointed to find some of his benefits are not fully insured.

We need to keep the pensioners' confidence. The bottom line is that workers' pensions should not and must not become just another hollow promise.

Mr. Chairman, I look forward to the testimony today. I believe it will help us assess the true status of our pension system.

Chairman PICKLE. Mr. Santorum.

Mr. SANTORUM. Thank you, Mr. Chairman, for your insight in having this discussion today. It is something I have been interested in for a long time. The area I come from in Pittsburgh includes our steel industry and LTV. They have had problems with their pension program, and a whole host of other companies that have had similar programs. So it is something that we have been aware of.

I asked the GAO for a study back in May 1991 about long-term liabilities for the Federal Government, the PBGC being one of them. Last year on the Budget Committee, Frank Guarini and I had a hearing about this issue and Mr. Lockhart testified, as well as several people from LTV and others who were affected. So it is something I am very interested in, something we need to move on.

I have been looking at this for a long time, as have other Members. We continue to study it, but at some point we need to begin moving forward on some of these reforms that have been proposed.

Mr. Chairman, your bill is an excellent one which I am supportive of and I think there are some other things which perhaps Mr. Lockhart will touch on later that we can be doing to improve the situation.

I look forward to working with you to make that happen.

Thank you.

Chairman PICKLE. The first witness we have this morning is Marvin Clarke. He is a retiree who worked for a company called the Hanlin Group from Moundsville, W.Va. This is a real life

retiree who has been affected by the pension operation under PBGC.

Mr. Clarke, if you will proceed with your testimony, we would be glad to hear you.

STATEMENT OF MARVIN D. CLARKE, RETIREE, HANLIN GROUP, INC., MOUNDSVILLE, W.VA.

Mr. Clarke. Mr. Chairman and members of the subcommittee, thank you for inviting me to speak before you. I am Marvin D. Clarke and I live in Moundsville, W.Va.

I have spent my entire life there with the exception of the 4 years with the U.S. Air Force. After being honorably discharged in September of 1955, I worked for Marx Toys in Glendale, W.Va., until the middle of December 1955. And then I took employment with Allied Chemical, January 3, 1956, as a shift worker.

I worked for Allied Chemical until May 1, 1980, when the plant was sold to Linden Chemicals & Plastics, which is now known as Hanlin Group. I worked for this company until July 1, 1990, which is 34.5 years of service. This was the proud happy day that my golden years began. I retired.

I had what I thought was a great pension along with an employee share of profits program and a matching dollar savings plan. I had been given an option of payment which I could receive it quarterly or every 6 months or wait 1 full year for the full amount in one lump payment. I elected to wait out the year, which would be July 1, 1991, and the money would be given to me by July 15, 1991. Hanlin also had gotten around to finalizing my pension in June 1991. I was also notified I had an increase of $115 retroactive to my date of retirement, July 1, 1990.

On July 10, 1991, Hanlin filed chapter 11. Thousands of dollars owed to me from the employee share of profits and the matching savings was also gone. This is the money my wife and I had planned to pay off our house. Our dreams had crumbled. This had forced us to continue paying house payments. Then we were notified that the pension fund was broke and the PBGC was notified. During the 4 months I had no income and before the PBGC took over the payment, I had talked to them several times. During one of the conversations, I had heard for the first time that my pension might be reduced because of my age, but then they also told me that if it was—it wouldn't amount to much, it would be very little. Those are the exact words used when I was told my age could reduce my pension; losing $700 of my pension isn't much. Without any kind of explanation, the PBGC cut my pension $700 per month for the rest of my life. I had to call and ask if they had made a mistake. I was told my pension was $700 over, which was to be paid under the law because of my age.

That $700 represents close to one-third of my pension.

I fail to understand a law that cuts my pension because of my age. Under this law a person could have been employed at the age of 37, made the same amount of money as I did in his last 5 years and he, with 21 years of service, would receive the same pension as I, which the PBGC tells me, it is the law, although I worked 13½ years more than him. More than just age should be considered

when determining what amount a person is entitled to, such as years of service, the person's health, how many dependents depend on him, the bills he has, such as house payments, life and medical insurance, and any other responsibilities the pensioner may have. These are problems that the person who considered retiring must think about before he retires.

We had requested that we be provided a "Summary Annual Report" for the Hanlin Group, Inc. Pension Plan. I received the second report this company had ever given us by mail on June 5, 1990, just days before I retired. It was for the period commencing on December 14, 1987, and ended on December 13, 1988.

In the report, it explained that the minimum funding standard of ERISA had a deficit of $37,349 and that the deficiency was funded immediately upon its discovery. If the report is accurate, it was probably the date Hanlin stopped funding the pension plan. And if this report is correct, it would appear to me that the month Hanlin filed bankruptcy is the month this fund would have been broke. I can also say that the picture given to the negotiating committee by the company did not compare with the report. We had been assured many times that the pension was secure. What reason would we believe otherwise? We had the law protecting it. We had the security of the ERISA Act to protect us.

In January 1991, Hanlin announced that the Moundsville plant would close. The State of West Virginia offered a loan of $500,000 and Marshall County offered $250,000 in tax relief if they would keep the plant open. Hanlin accepted their offers and 6 months later Hanlin filed for bankruptcy and closed the Moundsville plant.

Back in the late fifties or early sixties, I can remember reading of retirees in Texas losing their pensions. Here we are in the nineties and even with the security of the ERISA Act of 1974, we have not solved this problem.

Hanlin has destroyed me and my family. My wife, Diann, and my daughter, Stefanie, will suffer from this for the rest of our lives. Many of my union brothers and sisters back home know full well what I am talking about for they will also suffer. No company on Earth could have been mismanaged worse than this company was. A lack of management put us in this position.

I would like to rename the ERISA Act of 1974 to read, "The Employee Retirement Income Partial Security Act of 1974." It would no longer be referred to as ERISA. It would be referred to in my opinion as ERISPA.

I had the American dream. I never was laid off. I always had a paycheck, never had to apply for assistance or food stamps, never had to ask anyone for help and always paid my taxes with a smile.

Now I have lost my entire savings. I have lost most of my pension, and all this has affected my health causing me additional problems. What have I done wrong?

Chairman Pickle. Mr. Clarke, we appreciate your testimony. I don't know how many people we would find in the same shoes you have been if we gathered information across the lands about how some of the pension plans are working. Obviously it caused you great difficulty.

When you worked for the Hanlin Group for all these years, at the time you were working for them, did you have any idea that the pension plans were not fully funded?

Mr. CLARKE. No, sir. In fact, I was a member of the negotiating committee and we were assured many, many times that in spite of the problems the company had, the pension plan was secure.

Chairman PICKLE. When did you then first learn of the financial condition or the poor financial condition of the pension plan?

Mr. CLARKE. Not until they filed chapter 11 at which time they sent me a letter telling me the pension plan was broke which in the same month they filed bankruptcy.

Chairman PICKLE. You have lost $700 of your pension, approximately one-third of your retirement amount. I assume primarily because the way they interpret the tables your age would cause you to lose the $700 and all you got for an answer is it is the law—is that essentially what has happened to you?

Mr. CLARKE. Did I get anything additional from the pension—I didn't hear you, sir.

Chairman PICKLE. Yes.

Mr. CLARKE. They didn't give me no early retirement money or nothing. My pension money was pension money I earned. They owed me $700 of what I earned. I worked 34½ years in a chemical plant, a very dangerous chemical plant, outside in the dead of winter to earn my pension. Nobody understood my pension more than I did. I didn't need to go to the company to inquire how much I had coming. I knew how much I had coming because I worked on the negotiating committee. I earned every penny of the $700.

Chairman PICKLE. Thank you for your statement. Your example will be made known to the members of the committee.

Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Clarke. I relate to you because we are in the same age category. I understand some of the dilemmas, problems, and pressures which you are facing. In trying to get to the nub of the arithmetic, help me on this. Wasn't the major reduction in your pension caused because it was actuarially reduced because you retired early?

Mr. CLARKE. I didn't retire early, sir, as far as I am concerned. I could have retired when I was 52 years old on full pension with my company. That is why——

Mr. HOUGHTON. But the $700 is something which would have been given to you if you had stayed until the age of 65, but you were 60 when you got out?

Mr. CLARKE. I retired at the age of 57.

Mr. HOUGHTON. It was a mathematical step down from the original contract of $700?

Mr. CLARKE. According to the PBGC calculations yes, sir. I was 58 at the time PBGC took over the pension funds. According to the PBGC, under the ERISA Act, by law that is how much I am entitled to, which I was $700 over what is given out by law.

Mr. HOUGHTON. Another issue is really what the PBGC should do. Their insurance umbrella doesn't cover everything. It doesn't make up everything. If a company goes in the tank, it doesn't make it all up. There are certain restrictions. Do you think they were unfair in that process?

Mr. CLARKE. Definitely.

Mr. HOUGHTON. Can you break that down a little bit?

Mr. CLARKE. Well, I have never ever been informed that age had anything to do with the security of my pension. No one ever told me that until I lost my pension and I called the PBGC, which they told me I might lose a little bit, which I interpreted to be about $7 or something, not $700. Until that day, I never knew that age had anything to do with my retirement under the ERISA Act.

The ERISA Act says security of the employee's pension. It just says security. It used the word security. That means my pension is secure.

Mr. HOUGHTON. You would have assumed that you would have received exactly the same pension at 57 as you would have received at 65?

Mr. CLARKE. I assumed my pension that I was entitled to and worked for one way or other was protected not only by my employer, but by my Government, unlike other people before that that had lost their pensions entirely. I thought I was one of the lucky ones.

In talking to the company, yes, when you work for a company like Hanlin you are a little bit edgy about the pension being there, but I can always sit back and feel more relieved when you read the Employee Retirement Security Act. That sounds like it is there. It doesn't say anything about age. That is why I said in my statement it should be named "partial". To me the word security means that whatever I have is secure. I found out it was not secure.

Mr. HOUGHTON. That of course really has to be interpreted by the contracts and the laws which existed then. I don't know; there may have been some injustice, but it seems to me from listening to you the bulk of the problem has to do with the fact that instead of 65 you retired at 57, and therefore that was an actuarial reduction. Then the response of the PBGC was limited on top of that again by law.

It may not have been considered fair on your part. There may have been some other things, but those are the two driving factors I understand.

Mr. CLARKE. Well, I didn't—when you use the actuarial figures, I retired with fully what I had coming to me with my employer, my pension. That check came from Prudential. Like I said, I could have retired at full pension and went to work someplace else when I was 52 years old. You work on an 80-point system. Once you hit the 80 points, you can take your retirement and go. It is all secured and thinking and believing that your employer naturally is going to fund the pension plan properly, which apparently this company did not.

That is why I am in trouble and why I was put into the PBGC and not knowing—I was not concerned about my pension. I had heard there was a cap at the age—I heard there was a cap of $2,250. I was under the cap so I wasn't concerned.

When the PBGC told me that I may be reduced because of my age but it wouldn't amount to much—I didn't really get concerned then. I didn't think—much might be $7, $70, but it was $700. I think that is a bit too far.

Mr. HOUGHTON. Thank you. I have no other questions.

Thank you, Mr. Clarke.

Mr. KLECZKA. Mr. Clarke, I think we are missing the point. If in fact your employer would have fully funded your pension plan, you would not be here today and you would not have a problem. That is where the problem started and that is why you are in this dilemma today.

You indicated in your testimony that not only due to the bankruptcy did you lose one third of your pension, but your profit sharing was lost in total and also your matching savings plan with the employer, your contributions were also lost?

Mr. CLARKE. No, sir. That money—thank God the company didn't have control of my money.

Mr. KLECZKA. Did you get the company match also?

Mr. CLARKE. No, sir.

Mr. KLECZKA. So you only got half of that or whatever the percentage is. You indicated to the chairman that as an employee for 34 years and on the bargaining committee, you were never aware of the pension underfunding problems of the corporation. Did the company not give you and the hourly employees an annual statement indicating what the status might be?

Mr. CLARKE. No. You mean other than the required statement by law that the ERISA Act you mean——

Mr. KLECZKA. No, a fiscal calculation about the solvency of the plan.

Mr. CLARKE. No.

Mr. KLECZKA. You did receive some piece of paper when the bankruptcy was filed?

Mr. CLARKE. I received a paper from the company telling me that the pension plan was broke.

Mr. KLECZKA. By then it was too late to do anything about it?

Mr. CLARKE. Right.

Mr. KLECZKA. I am assuming you have kept in contact with other employees. Are you aware whether or not the salaried employees of this bankrupt company received the same treatment?

Mr. CLARKE. Up to the time I retired, all the years that I negotiated, I thought the company had one pension plan for all. I found out when they filed bankruptcy that they had two pension plans, one for the salaried and one for the hourly. There was more money in the salaried—the salary didn't go broke until I think 3 or 4 months after the hourly pension went broke.

Mr. KLECZKA. So what was the fate of those retirees who were part of management and part of the salaried pension plan? Did they receive the same cutbacks or the same treatment as you and the other hourly people did?

Mr. CLARKE. I don't know if there have been cutbacks. The salaried people are getting their pensions now, I understand, from the PBGC, but I don't know if anybody has been cut back. There have been other hourly people cut back in their monthly benefits.

Mr. KLECZKA. So we have found that, like you indicated, companies have many pension plans, sometimes covering various groups of employees, and we find also in the studies that have been done that salaried pension plans are fully funded whereas many hourly plans are not. And in my home district in Wisconsin we had a situation with the Allis Chalmers Co. wherein the hourly employees

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upon bankruptcy went to the PBGC. Those who were receiving supplemental pensions were denied that and are down to the basic, similar to what you are getting.

Then we find out that prior to the bankruptcy, the company fully funded all salaried plans so the management is fully being reimbursed for pension while the hourlies are not receiving what they were promised.

When you started receiving your payments, I assume there was a lag before you received the first PBGC check?

Mr. CLARKE. A 4-month lapse, yes.

Mr. KLECZKA. Were you informed that that check amount was an estimate and at a later date it will be determined what your proper amount will be?

Mr. CLARKE. My check is still an estimate.

Mr. KLECZKA. How long have you been receiving that check?

Mr. CLARKE. Since September of 1991, I believe. I was also informed that they overpaid me $700 for 4 months and when they get around to finalizing my pension, I will have an additional penalty of repaying the $2,800 I was overpaid for 4 months.

Mr. KLECZKA. The amount you are receiving today is still an estimate. When have you been told that is going to be determined to be——

Mr. CLARKE. I have no idea.

Mr. KLECZKA. Here is another situation from the same company in Wisconsin—these folks for 2 years received this estimate, and why PBGC could not finalize it, and now these folks late last year were told you were overpaid that entire period of time and now we are going to reduce your payments every month for your entire life. Because we don't have the capability to make that repayment actual, whether or not you overpay in your lifetime, you are going to suffer that reduced payment until you die. If you would repay it in 5 years, and live another 5 years, for that following 5 years before you pass away you would be paying a repayment that is not due and owing. That is something we will talk with PBGC officials, but I think that is a sad case to compound the problem you are facing.

Mr. CLARKE. I have lost $700 of my pension and eventually they will get around to collecting the overpayment. I have also been told that when I hit 62 years old they will reduce my pension further. When I am 62 years old, I will have lost more than 50 percent of my pension.

Mr. KLECZKA. Once they finally adjust that amount to the one they deem is due and owing, you will have another payback——

Mr. CLARKE. Yes, they will take another $100-and-some a month out of my paycheck until they get their money back.

Mr. KLECZKA. Thank you very much.

Mr. Santorum.

Mr. SANTORUM. Over the past last 10 years of the committee's existence, what did you negotiate, 3-year contracts? What was the length of the contracts you negotiated?

Mr. CLARKE. It was mostly 5 years. At one time we negotiated a 3-year contract. On the bankruptcy they were written on a 5-year pension plan.

Mr. SANTORUM. The company was in some sort of trouble the last several years of your working there. Was it a long-term problem that you saw the company was not doing well?

Mr. CLARKE. I don't understand.

Mr. SANTORUM. Was the company losing money? Was the company in trouble financially?

Mr. CLARKE. Yes.

Mr. SANTORUM. For the past several years?

Mr. CLARKE. Yes, sir. In fact we had given up 12½ percent of our wages to help the company stay in business in Moundsville.

Mr. SANTORUM. Was that the last contract?

Mr. CLARKE. I believe this was 3 or 4 years before I retired.

Mr. SANTORUM. Did you have concessions in prior contracts?

Mr. CLARKE. No.

Mr. SANTORUM. Were there dramatic increases in pension benefits to compensate for some of the wage losses? Were there any benefit enhancements to the pension side to sort of counterbalance the loss in wages?

Mr. CLARKE. You mean—we lost 12½ percent, but when we retired you got the 12½ percent back.

Mr. SANTORUM. So they promised it on the pension side and took it away.

Mr. CLARKE. Absolutely.

Mr. SANTORUM. Did they do any of that earlier on in other contracts where they couldn't afford maybe to give you the increases you wanted and gave you more money on the pension side——

Mr. CLARKE. No, I don't believe so.

Mr. SANTORUM. But the one instance that did occur when you took wage decrease, they promised to make it up on the pension side?

Mr. CLARKE. Yes, sir.

Mr. SANTORUM. That is something we hear a lot of, that a lot of companies who are not doing well and don't have the current revenues to pay wage increases, promise long-term obligation pensions in negotiations. Unfortunately in your case, they never pay them because they obviously aren't fiscally sound enough to make it into the long term.

That is a big problem and something that we are going to try to address. If they are going to ask for wage concessions then they can't promise higher pensions without having to fund the promise in the pension plan.

You and many union contracts are in a situation where you have companies foregoing current payments and promising long term. Then they find out that they are never there to deliver on the long term.

Thank you very much. I appreciate your testimony.

Mr. KLECZKA [presiding]. I recognize Mr. Brewster now.

Mr. BREWSTER. Thank you, Mr. Chairman.

I didn't hear all the testimony, but having looked at the written testimony, I find it is rather interesting. I think, Mr. Clarke, what you have experienced is what this committee is hoping we can prevent from happening to others in the future by ensuring proper funding of pension plans.

As far as PBGC handling it afterward, we hope it doesn't get to that point in the future. It obviously will from time to time, but I will look over your testimony further and we appreciate you being here.

Mr. KLECZKA. Mr. Herger.

Mr. Clarke, thank you for your very enlightening testimony today. Hopefully other pensioners from all our districts won't go through the same traumatic experiences you have.

Mr. CLARKE. Thank you.

Mr. KLECZKA. We will call the next panel comprised of James Lockhart III, former Executive Director of the Pension Benefit Guaranty Corporation; the CBO represented by Dr. Robert Reischauer; and from the U.S. General Accounting Office, Income Security Issues, Joseph Delfico.

Mr. Lockhart, if you would like to lead off today's second panel.

STATEMENT OF JAMES B. LOCKHART III, FORMER EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Mr. LOCKHART. Mr. Chairman and members of the subcommittee, I am pleased to be here to discuss PBGC's future. As a now former Executive Director, I appreciate your long and strong support of this program that is critical to the retirement security of 41 million Americans.

The past year has been very challenging. We have made changes to improve PBGC's financial systems and controls. Because of large underfunded terminations, the workload increased tremendously. The smooth handling of this workload is due to PBGC's hard-working employees, whom I would like to thank at this time.

When I arrived at PBGC almost 4 years ago we established the goal of becoming a service-oriented, well-managed, and financially strong insurance company supporting a healthy defined benefits system. To succeed we need accounting and legislative reforms.

GAO is auditing our 1992 accounts. Their opinion is several months away, but I am confident they will show a dramatic improvement. The work that we have just completed with a major accounting firm shows that the liability numbers in last year's annual report are materially accurate, as is the $9 billion to be reported for 1992.

While a vast majority of the Nation's defined benefit pension plans remain well funded, the insurance program is facing growing problems from poorly funded pension plans of troubled companies. In 1990 and 1991, losses reached a billion dollars and in 1992 they exceeded $800 million. PBGC's deficit for the single-employer program has grown over the past 3 years from $1.1 to $2.7 billion.

Underfunding in ongoing pension plans has doubled since 1990 to an estimated $51 billion. Well over $30 billion of the unfunded liabilities is concentrated in the plans of relatively few firms, in the steel, auto, tire, and airline industries. Financially troubled companies represent a near-term risk of about $12 to $20 billion. PBGC's future rests on these companies and a handful of companies that are not now troubled.

Using the estimates of these troubled companies, PBGC's latest 10-year forecast shows a pessimistic deficit range of $16 to $28 bil-

lion. That means at the end of 10 years from now we could see under a pessimistic forecast a deficit up to $28 billion.

It shows the large uncertainties that PBGC faces, as does OMB's forecast, claims of $25 to $45 billion over a 30-year period.

The financial problems are a consequence of fundamental weaknesses in the insurance principles supporting the program. The "moral hazards" of inadequate minimum funding rules, liberal guarantees, low premiums for underfunded plans, and low recoveries in bankruptcy encourage financially weak companies to underfund their pension plans.

TWA illustrates many of these hazards. Its pension plans are underfunded by over $1 billion, even though it is in full compliance with all the funding rules. Benefits were increased in bankruptcy. Creditors and Carl Icahn claimed the underfunding was only $200 million. He threatened to shut down TWA with the loss of 25,000 jobs if we did not release his joint liability. Our goal was to protect the pensions and try to insure an ongoing TWA.

Despite intense pressure, PBGC got a reasonable settlement. If the plans continue, PBGC will not have a loss, but if they terminate, our losses could be in the hundreds of millions of dollars.

Despite these problems, some say that there is no reason to be alarmed. I totally disagree. The time to act is now before there is an S&L-type crisis.

As the GAO stated in a December report:

> The cost of not taking action to address PBGC's moral hazard problem is that financially troubled sponsors will likely continue to behave in a manner that increases PBGC's potential claims, * * * if enough sponsors of well funded plans terminate their defined benefit plans, PBGC will eventually have to turn to the American taxpayer if it is to continue to meet its benefit obligations.

Opponents of reform have been fooled by the current cash flow accounting for the PBGC in the Federal budget. Accrual budgeting will show our real financial position.

There are four other major areas for possible reforms. The first, raising premiums for well-funded plans, should not be tried.

Second, the current inadequate minimum funding requirements should be changed. In so-called "flat benefit," usually union-negotiated plans, which represent about 25 percent of the plans PBGC insures, underfunding is increasing under present rules. The latest round of negotiations in the auto, steel, and rubber industries may have increased benefits by $9 billion.

The minimum funding proposals were crafted to improve funding in chronically underfunded plans. Based on PBGC's actuarial analysis, these proposals, had they been enacted in the early 1980s, would have substantially reduced underfunding in most of the major underfunded plans that constitute our current exposure.

Looking forward, they should reduce the time for full funding of plans from 30 years to 15 years. Critics have suggested that companies cannot afford to better fund their plans, often citing Chrysler as an example.

In a real landmark in PBGC's history, Chrysler proved otherwise, first by contributing $700 million more in 1990 than the minimum requirement, and then the paper said today, $2 billion equity offering just completed which had an unprecedented use of proceeds.

They will put the money raised, half up front and half later this year, into those pension plans.

The third reform is to further improve funding incentives and limit PBGC's exposure by restricting the future growth in guarantees in underfunded plans.

The fourth major area of possible reform would improve bankruptcy recoveries. These recoveries are shared with participants who have nonguaranteed benefits. Court decisions in the LTV and CF&I steel cases have gutted our recoveries in bankruptcy. Bankruptcy priorities reduce PBGC's and participants' losses and encourage better funding as pension plans would be treated as real debt by creditors.

In summary, PBGC needs legislative change to reduce the threat that growing pension underfunding poses to the insurance program and to the defined benefit pension system, which is a major component of American savings. The alternative of ever-escalating premiums will drive out the well-funded plans from this voluntary system, leaving PBGC and ultimately the taxpayer holding the bag for the underfunded plans. To echo the sentiments of numerous editorials, "The time to act is now before another crisis occurs."

Thank you and I welcome any questions you may have.

[The prepared statement and attachment follow:]

TESTIMONY OF JAMES B. LOCKHART III

Former Executive Director
of the
Pension Benefit Guaranty Corporation

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here to discuss the PBGC and its future. I am speaking today as a newly former Executive Director. I would like to say I appreciate your holding this hearing so early in the year which shows your support of this program that is critical to the retirement security of 41 million Americans and American savings.

The past year has been very challenging for PBGC. Internally, we have made changes to improve the financial management and internal controls. At the same time, because of large underfunded terminations, the workload increased tremendously. PBGC's ability to handle this workload and make progress is due to PBGC's hardworking employees, whom I would like to take this opportunity to thank.

Growing underfunding in some ongoing plans has made the future of the PBGC single-employer pension safety net very uncertain. To keep this vital insurance program viable, I believe major reforms are needed.

Overview of the PBGC and its Role

The Pension Benefit Guaranty Corporation protects the retirement benefits of over 41 million Americans in about 67,000 private defined benefit pension plans. Defined benefit plans provide a specified benefit related to the participant's age, years of service, salary, or some combination of these. Defined benefit plans are backed by dedicated assets in separate trust funds as well as the equity of the employers.

If a pension plan's trust assets are insufficient and the sponsoring employer can demonstrate financial distress so severe that the business cannot otherwise continue to operate, PBGC steps in to pay the pensions of workers and retirees. These claims are paid from statutory premiums collected from all employers who sponsor covered plans, recoveries from sponsors terminating underfunded plans, and investment earnings. PBGC is responsible for the retirement benefits of 424,000 participants in over 1,700 pension plans.

While a vast majority of the nation's defined benefit pension plans remain strong and well-funded, the insurance program is facing growing problems from poorly-funded pension plans of troubled companies. Despite aggressive efforts to prevent loss to retirees and the insurance program, claims against the PBGC have grown steadily. It took us 11 years to accumulate $1 billion in losses. In each of 1990 and 1991 losses reached a billion dollars and in 1992 they exceeded $800 million. PBGC's deficit for the single-employer program grew by two and one-half times over the past three years from $1.1 billion to $2.7 billion.

In addition to these losses, the Corporation is facing total underfunding of at least $51 billion, of which $12 billion to $20 billion is in plans that are termed "reasonably possible" losses in accounting parlance. For the longer-run, modelling by OMB of the PBGC program suggests up to $40 billion in future claims.

Financial Management

When I arrived at PBGC almost four years ago I established the goal of making PBGC a service-oriented, well managed and financially strong insurance program supporting a healthy defined benefit system. To succeed, we needed strong financial management and the ability to limit our future losses.

There were significant problems with PBGC's financial management systems and I wanted the assistance of the General Accounting Office (GAO) in identifying them. To help me identify these problems, I asked the GAO to examine our fiscal year 1990 financial

accounts, and the GAO found them unauditable. Our goal remains to begin annual audits and to work toward achieving auditable financial statements for fiscal year 1992.

GAO's fiscal year 1990 audit, as did their 1980 audit, found serious concerns with PBGC's premium systems, accounting and internal controls, and the methodology for evaluating our liabilities for future benefit payments. Their 1991 audit report confirmed these problems, but noted that we have made a major commitment to correcting them. We have focused tremendous attention and resources on correcting our problems and we have made substantial progress in addressing the weaknesses identified by the GAO and our Inspector General. Their opinion for 1992 is several months away, but I am confident they will show that a major portion of PBGC's accounts are auditable.

There has been concern that the lack of auditability means that our liabilities may be overstated. I can tell you the work that we have just completed with a major accounting firm shows that the numbers in last year's annual report are materially accurate. In 1992's annual report that will be published this month, they will exceed $9 billion.

Need for Legislation

Underfunding in ongoing pension plans has grown from an estimated $20 billion to $30 billion as stated in PBGC's 1990 Annual Report to an estimated $51 billion. Eighty percent of the increase is in single-employer plans.

Well over $30 billion of the unfunded liabilities are concentrated in the plans of relatively few firms, primarily in the steel, auto, tire, and airline industries. These underfunded plans cover about 5 million people. About half of these plans are associated with financially troubled companies and present a near-term, serious risk to PBGC of about $12 billion to $20 billion. PBGC's future rests on these companies and a handful of companies that are not now troubled. Using the range of reasonably possible losses PBGC's latest 10-year forecast shows a pessimistic deficit range of $16 billion to $28 billion. This range as shown on the attached graph shows the large uncertainties PBGC faces and better reflects the loss deterioration highlighted in GAO's December report, "Pension Plans: Hidden Liabilities Increase Claims Against Government Insurance Program." The President's Budget, using a model that incorporates a long view of the future, forecasts net claims to PBGC of $25 billion to $45 billion in today's dollars over the next 30 to 40 years.

The financial problems in the single-employer program are a consequence of fundamental weaknesses in the insurance principles supporting the program similar to the weaknesses of the now defunct Federal Savings and Loan Insurance Corporation. The "moral hazards" of inadequate minimum funding rules, liberal guarantees, low premiums for underfunded plans, and the probability of low recoveries from employers in bankruptcy still encourage financially weak companies to underfund their pension plans. Because of these moral hazards:

- Companies in financial difficulty view pension increases as cheap compensation, and their workers agree to these empty promises because of our pension insurance.

- Some companies have stopped making required contributions while in bankruptcy with the judges' approval.

- Some companies have allowed their plans to almost run out of money without violating the minimum funding standards.

- Lenders rarely put pressure on those companies to fund their plans, believing in optimistic funding assumptions and expecting pension claims will have no priorities. Creditors sometimes pressure distressed companies to terminate plans rather than fund them.

- Companies look on pensions as cheap debt and have failed to accumulate a "rainy day reserve" for subsidized benefits triggered by plant closings and early retirements.

One of our largest recent cases illustrates many of these hazards. TWA's pension plans are underfunded by over $1 billion, even though the company has complied with all the funding requirements. Despite the underfunding they increased benefits while in bankruptcy by almost $100 million in lieu of wage increases. Creditors and Carl Icahn, who owned 90 percent of TWA, downplayed the underfunding and our claims in bankruptcy. Their view of the underfunding being less than $200 million with no priorities was, unfortunately, in line with Judge Duffy's decision in the LTV case. Mr. Icahn tried to extract his group of affiliated companies--also known as the controlled group--from joint and several responsibility under the law for those pension plans. His threat was the shutting down of TWA and the loss of 25,000 jobs. Our goal was to protect the pensions and to have a viable, ongoing TWA, if possible.

Despite intense pressure, PBGC hung in and got a reasonable settlement: a $200 million loan from Icahn to TWA; a $300 million secured note from TWA to its pensions; Icahn backing for TWA's minimum funding with a face amount of $200 million and expected payment of $80 million over the next five years; and $240 million over eight years from Icahn if the plans terminate. If the plans continue, PBGC will not have a loss; but if they terminate, PBGC's losses could be in the hundreds of millions. This messy, no win type of situation vividly points out the need for PBGC reforms.

Many have asked why plans continue to be underfunded 18 years after ERISA's minimum funding standards were enacted and five years after the funding reforms of 1987. In fact our studies show that underfunding has grown in absolute and real terms since 1982. The unsettled legal status of our bankruptcy claims and the absence of sufficient co-insurance in the program lessen the interest that creditors or workers have in plan funding. Also, the funding rules themselves continue to fall short:

o In "flat benefit" plans, which represent about 25 percent of the universe, benefits are often increased at three- or five-year intervals in contract negotiations. Amortization of such increases under current law is not fast enough to prevent funding deterioration, especially in plans with a high percentage of retirees and older workers. These plans are only about 75 percent funded on average. Although funding rules do not allow these plans to anticipate future benefit increases, there is nothing preventing them from being 100 percent funded. And in fact some are overfunded. In contrast, so-called final pay plans are about 145 percent funded on average.

o The rules also allow a company, regardless of funding levels, to reduce contributions immediately if they have better than expected investment or actuarial experience. Consequently, companies whose plans are billions of dollars underfunded can and have taken multi-year funding holidays.

Despite our deficit of $2.7 billion, problems like TWA, and the projected losses of up to $45 billion, some say that there is no reason to be alarmed. I disagree. The time to act is now before there is a S&L type crisis. Without action, the Congress will have to raise premiums yet again, which will drive the well funded plans out of this voluntary defined benefit plan system. Even some of the opponents of reform admit that this type of "en masse" withdrawal could cause a crisis.

The "en masse" withdrawal has already occurred with smaller plans. We are losing 10 percent a year and are 43 percent down from our peak coverage. Luckily, larger plans are not yet terminating so our premium base is holding steady.

As the GAO has stated, "The cost of not taking action to address PBGC's moral hazard problem is that financially troubled sponsors will likely continue to behave in a manner that increases PBGC's potential claims. PBGC is concerned that rising claims may lead to the need to increase premiums, in effect forcing sponsors of well-funded plans to pay for the broken promises of sponsors who did not adequately fund their plans. If premiums are not raised sufficiently or if enough sponsors of well-funded plans terminate their defined

benefit plans, PBGC will eventually have to turn to the American taxpayer if it is to continue to meet its benefit obligations."

Proposed Reforms

Opponents of reform have been fooled by the current cash flow accounting for the PBGC in the federal budget which ignores PBGC's present and future liabilities. Under the current cash flow treatment of the PBGC in the Federal Budget, the premiums paid by covered plans and investment earnings on them are offsets to Federal outlays. Only about half of the benefit payments and administrative expenses -- those that are paid from PBGC's revolving funds are treated as Federal outlays. Under cash flow Federal budgeting, PBGC now has a positive cash flow annually of almost $800 million. This does not account for the fact that, on a present value basis, PBGC's liabilities for single-employer, terminated plans using generally accepted accounting principles, exceed PBGC's assets by $2.7 billion. This deficit reflects monthly payments we are committed to pay participants in plans already terminated or that are expected to terminate in the near future.

In the year that Pan Am's plans terminated, Pan Am's plans caused an outlay increase of only $10 million in the federal budget while our losses exceeded well over half a billion dollars. Cash flow budgeting is the same budgeting that helped obscure the S&L problem for so many years. Accrual budgeting will show the real financial position of PBGC.

There are four major areas for reforms. Three were proposed by the PBGC over the last couple of years and I will discuss each of them. The other is to raise premiums. I do not believe premiums for well-funded plans should be raised. Premiums for underfunded plans should probably be raised, but only after the reforms are implemented so that PBGC knows what it is insuring. That will give PBGC time to complete its modelling efforts and make a firm recommendation as to how to better risk adjust the premiums for underfunded plans.

Minimum Funding Rules

The current minimum funding requirements have proven inadequate in a number of respects and, if left unchanged, will not significantly reduce the underfunding in chronically underfunded plans.

In so-called "flat benefit" plans, which represent about 25 percent of the universe, the funding gap can be considerable. These plans provide a flat benefit per year of credited service. We estimate that the latest round of negotiations in the auto, steel and rubber industries may have increased benefits by $8 to $9 billion.

While helpful, the "deficit reduction contribution" that was enacted in 1987 does not adequately address the problems posed by these flat benefit plans. In flat benefit plans it is possible to be in full compliance with existing minimum funding rules even when annual benefit payments far exceed annual contributions to the plan. In fact, many of the largest underfunded plans have taken contribution holidays since 1987.

The PBGC proposed legislation last year to increase minimum funding for plans presenting the greatest exposure and risk to PBGC. The rules for fully-funded plans, which make up the vast majority of defined benefit plans, and for small plans with under 100 participants, would not be changed.

The strongest proposed funding rule is a solvency maintenance requirement which would require sponsors to contribute at least an amount equal to benefit payments made during the year plus interest on the plan's unfunded liability. Underfunded plans with a heavy concentration of retirees and high amounts of benefit payments would be most affected by this rule. To ease the transition to the new rules and to provide sponsors an opportunity to adjust their future pension contribution expectations, the solvency

maintenance requirement would be phased in over a five-year period. Some sponsors have stated that they will have large increases in contributions, but that is because of their recent cutback in real contributions.

These minimum funding proposals have been crafted to improve funding in chronically underfunded plans. Further, they are structured to assure that a greater portion of investment gains will result in improved plan funding ratios rather than inuring to the benefit of the sponsor through reduced contributions.

Based on PBGC's actuarial analysis, these proposals, had they been enacted in the early 1980's, would have substantially reduced underfunding in most of the major underfunded plans that constitute our current exposure. If we assume that we continue to have strong investment returns over the next decade or so, enacting these proposals should, on average, reduce the time span for full funding of plans from 30 years to 15 years.

Restrictions on PBGC's Guarantee

To further improve funding incentives and limit PBGC's exposure, the PBGC proposed restricting the future growth in PBGC's guarantee for benefits promised in underfunded plans. Recently $100 million in pension benefit increases were approved by the bankruptcy court not only in the TWA bankruptcy but also the Continental bankruptcy, despite PBGC's protests.

Under the proposals, PBGC would not guarantee new benefits or benefit increases due to plan amendments for plans that are not fully funded for vested benefits until they become fully funded. In your legislation, Mr. Chairman, you introduced an alternative that would make the sponsor of an underfunded plan fund or provide security before giving a benefit increase.

Either approach should encourage better funding and more realistic benefit promises. Furthermore, the proposal will curb the practice of accumulating unfunded benefit increases over many years for which PBGC's premium payers then have to foot the bill when the plan terminates.

Bankruptcy

The third major area of proposed program reforms would improve PBGC's recoveries from bankrupt sponsors of terminated plans. PBGC generally has both priority and non-priority unsecured claims in bankruptcy proceedings. PBGC has long asserted that unpaid contributions due during bankruptcy proceedings and a certain portion of PBGC's claims for pre-bankruptcy unpaid contributions and employer liability for unfunded benefits are priority claims. It should be remembered that any recoveries PBGC receives in a bankruptcy are shared with participants who have non-guaranteed benefits.

Court decisions in the LTV and CF&I cases, if allowed to stand, effectively preclude payment of pension contributions during bankruptcy, strip PBGC's claims of their priority status, and in the LTV case, denies PBGC the right to specify the actuarial assumptions used to determine the amount of our claims. These decisions, which rely solely on interpreting the Bankruptcy Code and ignore related provisions of ERISA and the Internal Revenue Code, will lead to more and larger terminations of underfunded plans. In particular, the decision removes one of our key coinsurance features, which is the incentive for creditors to encourage better funding in order to limit PBGC's priority claims when an underfunded plan terminates.

On average, less than 20 percent of our claims in bankruptcy are entitled to priority treatment. Although small, these priority claims result in PBGC's claims being treated seriously before and during bankruptcy.

Bankruptcy protections obviously help reduce PBGC's losses once an underfunded termination occurs, but also encourage better funding before bankruptcy. Companies would

have less incentive to terminate underfunded plans if PBGC could recover significant amounts when plans terminate. Creditors would treat underfunded pension plans as real debt, creating a market-based incentive for better plan funding. Although these changes are under the jurisdiction of the Judiciary Committee, I encourage you to push bankruptcy reforms as part of a total package.

Conclusion

Before concluding, there are two misconceptions I would like to clear up. Firstly, there are those that say we should not use the analogy to the S&L system. Although the magnitude of the potential risks to the taxpayer is less, the analogy is very apt because PBGC's, like FSLIC's insurance is not based on sound insurance principles. Without a sound foundation, companies will take advantage of the system and losses will continue to mount and also the defined benefit system will continue to shrink, which may have a severe impact on American savings.

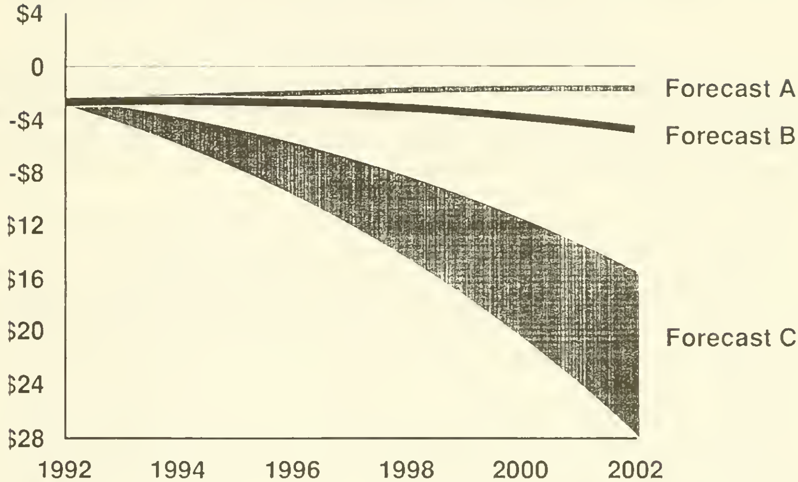
The second misconception is that PBGC's emphasis on underfunding and, in particular the "Top 50" list of underfunded plans is useless as the companies on it cannot afford to better fund their plans. Just last month in what I consider a real landmark in PBGC's history, Chrysler punctured that balloon. Not only did it announce in 1992 that it contributed $700 million more than the minimum required, but also it announced a giant $1.5 billion equity offering. The unprecedented "use of proceeds" was stated as funding the pensions. The best way to get other Top 50'ers to follow Chrysler's lead is legislative reforms.

In summary, PBGC needs legislative change to reduce the threat that growing pension underfunding poses to the insurance program and to the defined benefit system which is a major component of American savings. We need greater incentives to better fund existing and new pension promises, not higher premiums. Ever escalating premiums are counterproductive, driving out the well funded plans from this voluntary system. That could leave us and ultimately the taxpayer holding the bag for the underfunded plans. To echo the sentiments of PBGC's former Chairman, Secretary Lynn Martin, and numerous editorials, "The time to act is now before another crisis occurs."

Thank you for the opportunity to testify before the Subcommittee. I welcome any questions you may have.

PBGC 10 Year Forecast

(Dollars in billions)



Chairman PICKLE [presiding]. Thank you.

Mr. KLECZKA. The next witness is Dr. Reischauer from the Congressional Budget Office.

STATEMENT OF ROBERT D. REISCHAUER, PH.D., DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. REISCHAUER. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to discuss with you some of the findings that are contained in the Congressional Budget Office (CBO) report on controlling losses of the Pension Benefit Guaranty Corporation (PBGC). The report was prepared for the use of this subcommittee and is being released today.

With your permission, I will submit my prepared statement for the record and will confine my remarks to three points.

The first of these is that the Federal pension insurance system has accumulated a sizable deficit that is expected to grow unless the program is modified. Despite six increases in insurance premiums over the past 19 years, the PBGC has run a deficit since it was created in 1974.

At the end of 1991, PBGC had $2.5 billion more in pension liabilities than in assets in its single-employer plan. The PBGC has estimated that this figure could increase by $12 billion if the financially weak firms whose failure PBGC judges to be "reasonably possible" do, in fact, fail. Studies focusing on a longer planning horizon have estimated that the present value of the foreseeable deficit for PBGC exceeds $35 billion.

My second point is that these accumulated and projected losses may result in an unintended and costly taxpayer bailout of PBGC. Although in a strict legal sense the Government is not liable for any of the obligations incurred by PBGC, recent experience with deposit insurance and farm credit systems suggests that the Congress would not allow PBGC to default on federally insured pensions and thereby threaten the income security of retirees or workers whose pensions had been guaranteed by the Government.

My third point is that the Congress could lessen the likelihood that a large infusion of taxpayer funds will be required by adopting a combination of shortrun policy adjustments and long-term structural reforms. The short-term policy adjustments would be directed at restoring PBGC's financial balance by reducing expected future claims.

This objective could be accomplished in a number of ways which are detailed in our study. For example, funding requirements could be increased for insured plans. These requirements might involve shortening the time period over which firms can amortize benefit promises or requiring that funding over a year equal at least as much as was paid out during that year.

Another approach would be to align individual premium charges more closely with the expected claims from each pension plan. This goal could be accomplished if the cap on premiums of $72 per participant were raised or eliminated or if premiums were linked to the financial health of the firm.

A third policy approach would be to severely restrict the ability of sponsors to increase insured pension benefits if they are finan-

cially unable either to raise their plan's funding or to pay a fair premium. The considerable exposure that PBGC faces from firms in financial trouble who sponsor underfunded plans could be reduced if underfunded plans were required to collateralize all benefit increases.

Long-term structural changes should be directed at giving PBGC the incentive and tools with which to take remedial action when financial imbalances threaten. The pension insurance system often needs prompt policy adjustments to offset the change in risk posed by some pension plans, but under the current system, adjustments are made by the Congress in a deliberative rather than a swift manner.

Because one of the most important instruments for informing and motivating congressional action—namely, the budget—misstates the financial performance of PBGC, it is not surprising that needed adjustments are often postponed. The budget only tracks cash inflows and cash outlays. Therefore, it shows PBGC as a surplus account, since current premiums exceed benefit outlays, even though the liabilities of PBGC are growing faster than its assets.

This situation could be improved if PBGC were given more authority to adjust policy. The Congress, of course, could retain its authority to overrule agency decisions, or the Congress could require that PBGC provide it with more timely information. This requirement would allow Congress to carry out its legislative duties with greater efficiency.

Several budgetary reforms could also prove useful. PBGC could be removed from the pay-as-you-go scorecard to protect the account from budget gimmickry or from being an obstacle to sensible reforms.

The Congress could also change PBGC's budgetary treatment to bring forward-looking financial information into the budget. Finally, mechanisms could be instituted that make it costly for the Congress to postpone allowing PBGC to receive adequate funds to pay for its liabilities.

Along with the shortrun policy adjustments and the longer-term structural reforms that I have mentioned, PBGC should be encouraged to continue correcting the weaknesses in internal control that have been identified by the General Accounting Office in its numerous testimonies and studies.

To sum up, our Federal pension insurance program has a large and growing budget problem. There are shortrun and longrun policies that can address this problem. If these measures are not adopted, the chances that the taxpayer will once again be called on to bail out a flawed Federal program will increase, and the American people will have yet another reason to question the competency of their Government.

[The prepared statement follows:]

Statement of
Robert D. Reischauer
Director
Congressional Budget Office

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to discuss the federal pension insurance system and the federal agency that administers this program, the Pension Benefit Guaranty Corporation (PBGC). This topic is discussed in more detail in the Congressional Budget Office report on controlling losses of the PBGC that was prepared for this Subcommittee and is being released today. I intend to emphasize three points in my statement this morning.

First, the federal pension insurance system, which was intended to guarantee defined benefit pensions at no cost to taxpayers, has accumulated a sizable deficit. Unless the program is modified, this financial imbalance is expected to deteriorate significantly.

Second, although these accumulated and projected losses are unlikely to threaten the income security of retirees or workers whose pensions are guaranteed by the federal government, they may result in an unintended and costly bailout of PBGC by U.S. taxpayers.

Third, the Congress could adopt a combination of short-run policy adjustments and long-term structural reforms that would greatly improve the chances that this insurance program will operate in the future on a financially sound basis. The sooner the Congress adopts such measures, the less likely that a large infusion of taxpayer funds will be required.

PBGC'S FINANCIAL IMBALANCE

Federal insurance against losses from pension termination protects the retirement benefits of those citizens whose privately funded pension plans provide specified or defined benefits. PBGC insures--subject to limits--workers and retirees against the inability of their pension fund and its sponsor to pay promised benefits. When a firm sponsoring a pension plan terminates its underfunded plan (a pension plan whose assets are less than its pension liabilities), PBGC becomes the trustee for the plan, acquires the plan's assets, and pays guaranteed retirement benefits.

When a plan is terminated, PBGC becomes financially responsible for the gap between the value of acquired assets and insured pension benefits. PBGC's only source of funds to fill the gap consists of premiums paid by sponsors of defined benefit plans, augmented by a claim against the sponsor and by earnings on assets held.

Despite six increases in insurance premiums over the last 19 years, PBGC has run a deficit since it was created by the Employee Retirement Income Security Act of 1974 (ERISA). Today PBGC, which insures nearly 32 million workers in single-employer pension plans and more than $900 billion in defined pension benefits, has $2.5 billion more in pension liabilities than in assets. Furthermore, PBGC's obligations to pay pension benefits, in excess of anticipated assets from terminated plans, are increasing. Currently, PBGC estimates that financially weak firms, whose failure is "reasonably possible," are sponsoring pension plans with $12 billion more in pension liabilities than in assets. Studies focusing on a longer planning horizon have estimated that the present value of the foreseeable deficit for PBGC exceeds $35 billion.

ADVERSE EFFECTS OF PBGC LOSSES

Although ERISA states that the U.S. government is not liable for any obligation or liability incurred by PBGC, recent experience with deposit insurance and the farm credit system suggests that the Congress would not allow PBGC to default on federally insured pensions even if PBGC losses were to grow into tens of billions of dollars. The federal government's

commitment to its insurance promises, expressed through repeated reforms of PBGC, does not appear in doubt.

Nonetheless, consistency with legislative intent as well as equity and efficiency require that losses in the federal pension insurance system be addressed and controlled. As originally enacted and as amended, ERISA contains an explicit provision governing the financing of the pension insurance system: costs are to be covered by premiums. This legislation allows firms to avoid paying these premiums, however, by terminating their defined benefit pension plans and replacing them with defined contribution plans, which require no insurance.

The requirement that the pension insurance system be operated on a self-supporting basis has three important implications. The first is that voluntary participation of sponsors and workers in defined benefit plans prevents the federal government from raising premiums and other costs of insurance above the benefits the firms and employees receive from it. If sponsors of insured pension plans believe that their premiums are excessive, they may leave the insurance pool by terminating their defined benefit pension and establishing a noninsured plan. By terminating their defined benefit plans, firms can escape paying a premium that exceeds the benefits they expect from the insurance.

A second implication is that it is possible to collect premiums sufficient to cover expected losses from the sponsor of a terminated plan only before the losses have occurred--before costs are "sunk." After PBGC has taken over a plan to avoid a pension default, the failed sponsor will be unable to pay the costs it has imposed on the system, and surviving firms may be unwilling to pay premiums to cover old losses.

These two implications lead to a third. If PBGC continues to accumulate unfunded losses and if sponsors continue to leave the insurance pool, a form of involuntary assessment or tax may be necessary to pay these losses. Such taxes may have undesirable effects, however, as firms adjust to and try to avoid the new charge. For example, assume recurring surcharges are imposed on the surviving sponsors of defined benefit plans to finance past losses of PBGC. This factor will then tend to depress the number of defined benefit plans below the level that firms and employees would choose without the tax.

Thus, PBGC's losses should be controlled and funded by fair premiums before claims are made. This type of funding will ensure that those who impose losses on the insurance system have to bear the anticipated costs of their own actions; avoid the distorting effects of taxes to finance old losses; encourage the continuation of defined benefit plans; and minimize taxpayer costs and, thereby, strengthen the Congressional commitment to this program. Continuing current PBGC policy may encourage firms, especially those under financial stress, to engage in high-risk behavior such as not fully funding their pension plans or offering increased pension benefits as a substitute for wage increases.

PBGC's past losses have already resulted in some inequities. To the extent that past losses have been made up from program operations, these losses have been paid by surviving sponsors and their workers, whose premiums fund the operation of PBGC. To the extent that the losses remain on PBGC's books, they are implicitly paid by taxpayers, whose backing of PBGC gives its guarantee credibility even though its liabilities exceed its assets.

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OPTIONS FOR REFORM

The Congress has a number of policy options available to it that would promote the prefunding of insurance losses and enable the system to avoid "sunk" costs, those that once incurred cannot be financed easily with avoidable premiums. These options are of two distinct types: short-term policy adjustments to restore financial balance and long-term structural changes to minimize the accumulation of sunk costs.

Policy Adjustments

The current financial imbalance of the federal pension insurance system is the result of an excess of claims over premium income. Remedial policy adjustments would reduce expected future claims by increasing the funding requirements for insured plans, aligning individual premium charges more closely with the expected claims from each pension plan, and--when the sponsoring firm is financially unable either to raise its plan's funding or to pay a fair premium--severely restricting the ability of the sponsor to increase insured pension benefits. Along with these policy adjustments, PBGC should continue correcting internal control weaknesses identified by the General Accounting Office.

Higher Funding Requirements. Guaranteed benefits in single-employer pension plans are underfunded by $40 billion, according to PBGC. This sum is an increase of $9 billion over last year. The 50 firms with the highest level of underfunding hold 60 percent of total underfunding; four firms hold 43 percent. Existing law permits pension plans to accumulate underfunding. For example, minimum funding rules allow firms to amortize increases in benefits, thereby spreading funding over many years. During the amortization period, firms may not have enough money in their pension plan to make good on their pension promises. In particular, flat-benefit plans (in which benefit payments are a flat dollar amount for each year of service) are often underfunded as they amortize recurring increases in pension promises. PBGC reports that flat-benefit plans, on average, are only 75 percent funded.

Several alternatives to current funding policy exist. The Congress could, as it did in 1987, shorten the time period over which firms can amortize benefit promises. Another option is to base one standard of the required funding of a pension plan on the amount of its cash outlays; funding over a year would have to equal at least as much as was paid out that same year. This type of "cash flow rule" for underfunded plans would be especially effective in accelerating full funding by firms with more retirees than current employees.

However, full funding comes at a cost. First, federal tax collections will decline with increases in tax-deferred pension funding. Second, requiring firms to fund their pensions limits their flexibility in finding the highest value for the use of their funds. Forcing some profitable firms to stockpile funds for payments to be made many years in the future could ultimately increase the risk of these firms failing.

Risk-Adjusted Premiums. PBGC currently charges insured firms a flat-rate premium of $19 per participant and a variable-rate premium of $9 per $1,000 of plan underfunding per participant. Total premiums per participant are capped at $72. The cap on premiums limits the degree to which they can increase with underfunding. Because of these limits, the current premium is fairly constant over a wide range of risk. Accordingly, firms that are suffering financial stress and are more likely to make a claim against PBGC could pay about the same premium as financially healthy firms. The premium is

restricted, therefore, in its ability to discourage firms from pension underfunding and other risky behavior. A number of reforms, such as linking the premium to the financial health of the firm or removing the cap, would provide a greater incentive to firms to take fewer risks with their pensions.

Restrict Ability of Troubled Firms to Grant Increases in Benefits. PBGC faces large claims from firms that are in financial trouble and that sponsor underfunded plans. PBGC has found that in the five years before a pension plan is terminated, the plan's funding ratio drops from 80 percent to 40 percent. Although much of this underfunding results from an increase in pension payouts linked to the reduction in a firm's work force, some of the increase develops from firms who cope with financial difficulty by increasing insured benefits in lieu of wages. For example, PBGC reports that Trans World Airlines increased its insured pension benefits by $100 million while in bankruptcy. Without federal pension insurance, workers would be unlikely to accept pension promises from financially weak firms. To help reduce the losses from these high-risk firms, several reforms are aimed at limiting benefit increases by sponsors of underfunded plans, such as reforms requiring underfunded plans to collateralize all benefit increases, as proposed by Chairman Pickle.

Structural Reforms

The current tendency of PBGC toward deficits reflects a structural deficiency: nothing in the current system permits the insurer to take remedial action in response to financial imbalance. The pension insurance system often needs prompt policy adjustments to offset the change in risk posed by some pension plans, but under the current system, adjustments are made by the Congress in a deliberative rather than a swift manner.

Because the budget--one of the most important instruments for informing and motivating Congressional action--misstates the financial performance of PBGC, it is not surprising that needed adjustments are often postponed. As the pension insurance program is accumulating losses, the budget shows this activity as being not only self-supporting but contributing to a lower federal deficit. Although PBGC has accumulated $2.2 billion in losses since 1974, it has reduced the measured federal deficit by $2.3 billion.

The budget provides this misleading information about PBGC because it currently focuses on financial data unrelated to PBGC's long-term financial condition. The essence of this condition is that PBGC is piling up liabilities faster than it is building assets. Since the budget only tracks cash, it counts the excess of current premiums over benefit outlays. But the budget ignores the accumulation of assets and liabilities from terminated plans. PBGC's true financial position has little to do with today's payments and receipts. Rather, the commitments PBGC has made for pension payments in the future and the assets and premium payments it will receive determine PBGC's financial health.

Many alternative structural reforms for PBGC could be considered. For example, the current responsibility for PBGC policymaking could be reallocated so that the agency has more authority to adjust policy. The Congress, of course, could retain its authority to overrule agency decisions, or it could require that PBGC provide more timely information to it. This provision would allow the Congress to carry out its legislative duties with greater efficiency. If the Congress believes that neither it nor PBGC can manage the pension insurance program, then use of private-sector insurers and capital may be appropriate.

Given the current budgetary misinformation provided to the Congress, several budgetary reforms could also prove useful. In the short term, the Congress could remove PBGC from the pay-as-you-go scorecard. This change would prevent policy adjustments that improve PBGC's cash flow from financing spending increases in other programs. The Congress could also change PBGC's budgetary treatment so that more forward-looking financial information is in the budget. Finally, mechanisms that make it costly for the Congress to postpone allowing PBGC to receive adequate funds to pay its liabilities could be instituted.

CONCLUSION

Current federal pension insurance policy contains a statutory and structural inconsistency. On the one hand, the Congress clearly intends to protect workers from losing their pension benefits, and it intends to finance the cost of this protection from insurance premiums. The Congress has even gone so far as to disclaim in law the financial responsibility for the losses of PBGC. On the other hand, the government has not created an institutional structure that is capable of managing the program until self-sufficiency is reached.

Without reform, PBGC's deficit is expected to increase by tens of billions of dollars. These losses will squander scarce resources because they are unnecessary to provide the intended benefits to the insured. Consequently, if the federal pension insurance system is to achieve its mandated objectives, program adjustments and structural modifications such as those discussed here will be required.

Mr. KLECZKA. We will hear from Mr. Delfico from the GAO. Mr. Delfico is the Director of Income Security Issues.

STATEMENT OF JOSEPH F. DELFICO, DIRECTOR, INCOME SECURITY ISSUES, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. DELFICO. With me today are Harry Johnson, Robert Hughes, and Ray Occipinti, who helped prepare this testimony. Thank you for inviting me here to discuss the problems facing the Pension Benefit Guaranty Corporation. In December 1992, as part of a series of reports on high-risk areas, we reported our concerns about PBGC. In our view, successfully addressing PBGC's problems involves management reforms, modification of the pension funding rules, and possibly changes in the insurance premium. Today, I would like to briefly discuss these topics and discuss our work for the subcommittee on benefit increases given by a selected group of underfunded plans.

PBGC has weaknesses in internal controls and financial systems. We have been unable to audit PBGC's financial statements. Nobody can effectively monitor PBGC's financial condition without reliable financial statements. PBGC also has serious problems with its premium accounting and collection processes.

Over the past 2 years, PBGC has made substantial progress on its internal problems. While more must be done, we believe that PBGC has improved enough to allow us to complete a full audit of its balance sheet.

Even with improved management, PBGC has limited ability to control its exposure to losses from underfunded plans. PBGC currently has a positive cash flow—annual premium and asset incomes exceed its annual benefit obligations and administrative costs. But its single-employer fund deficit was $2.5 billion at the end of fiscal year 1991, and when potential terminations are considered, PBGC's financial condition looks worse. PBGC recently estimated that about $12 billion of the amount owed by financially troubled companies constituted reasonably possible losses to PBGC.

In estimating underfunding, PBGC adjusted plans' financial data because plans' financial reports—prepared on the basis that plans are ongoing operations—do not reflect the financial conditions of plans when they terminate. Recent work by us supports PBGC's view.

In a December 1992 report, we studied 44 terminated plans that accounted for 96 percent of the 1986 to 1988 claims against PBGC. PBGC determined that these plans had unfunded liabilities of $2.7 billion at termination—$1 billion higher than shown on the plans' last pretermination reports.

Eighty percent of the nearly $1 billion in hidden liabilities was due to PBGC's higher estimate of liabilities from using different actuarial assumptions to value liabilities and the payment of shutdown or special early retirement benefits. The interest rate assumption had the greatest impact; using PBGC's rates increased unfunded liabilities by 31 percent.

PBGC has few tools to control its exposure to plan liabilities. Plan sponsors with difficulties sometimes increase the exposure

and risk of PBGC. They know that if the plan terminates before benefits are fully funded, PBGC will assume responsibility for them. PBGC's only means of restricting its losses are to persuade the sponsor to better fund the plan or to terminate the plan. Even when PBGC can do so, it tries to avoid terminating a plan because such action is onerous to all involved.

Two design features of ERISA—the premium structure and minimum funding standards—also limit PBGC's ability to control its risks. Well-funded plans are subsidizing underfunded plans through the premium structure. Although underfunded plans pay an additional variable premium, the capped variable premium underchanges underfunded plans for the risk they pose.

ERISA's minimum funding standards do not ensure that all plan sponsors will make sufficient plan contributions to pay promised benefits upon termination. For example, plan sponsors may increase benefits even if the existing benefits are not fully funded, and benefit increases can be amortized over a 30-year period.

As a result, many of the plans that were underfunded when ERISA was enacted still remain underfunded. We are currently assessing the impact of the 1987 legislation to strengthen the minimum funding standards. In the meantime, current work shows that some underfunded plans are increasing their benefits and their underfunding.

You requested that we look at 8 companies on PBGC's list of the 50 companies with the most underfunded pension plans to determine the extent of their underfunding, to determine whether they recently increased benefits, and how any increases were funded. Our work, based on companies' data, show that some significantly underfunded plans provided benefit increases that further increased their liability.

In plan year 1991, or 1990 for some plans, the eight companies had 68 pension plans—33 overfunded and 35 underfunded The overfunded plans were overfunded by about $2.7 billion. The underfunded plans were underfunded by about $10.7 billion, with liabilities of $31.8 billion and assets of $21.1 billion. For 49 of the 68 plans, the ratio of assets to liabilities had declined. In other words, overfunded plans had less surplus than they had the year before or became underfunded, and underfunded plans became more underfunded.

Of the 35 underfunded plans, 18 had increased benefits in 1991. While some of the increases were relatively small, others were substantial in relation to the plans' unfunded liability and increased accrued liability. For example, the benefit increases for one plan were equal to 59 percent of its unfunded liability and 54 percent of its accrued liability increases.

Overall, the benefit increases by the 18 plans were about $2.2 billion, which was about 20 percent of the amount these plans were underfunded for 1991 and 6.8 percent of the 1991 accrued liability.

Benefit increases accounted for about 39 percent of the increase in unfunded liabilities between 1990 and 1991. Though this is significant, we are also looking into other factors that influence liability growth.

In conclusion, as long as pension plan underfunding persists, the pension insurance program and plan participants' benefits are at

risk. We believe this is the time—while PBGC still has a positive cash flow—to develop solutions to better fund pension promises. We support more effective funding standards.

Reducing underfunding would limit PBGC's future exposure and appropriately target the greatest threat confronting it—underfunded pension plans. Although tax deductions for strengthened funding would increase the Federal deficit in the short run, it is a necessary step to avoid potentially significant future costs.

In addition, the Congress should consider whether the overall premium ceiling and existing variable premium rate best reflect the risk to PBGC. Raising premiums by making the variable rate premium more risk related would focus on the underfunded plans that pose the greatest threat to the program and reduce PBGC's deficit.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other members may have.

Mr. KLECZKA. Thank you.

[The prepared statement and attachment follow:]

United States General Accounting Office

GAO

Testimony

Statement of Joseph F. Delfico
Director, Income Security Issues
Human Resources Division

Thank you for inviting me here to discuss the problems facing the Pension Benefit Guaranty Corporation (PBGC). Several years ago GAO placed PBGC on its "high-risk" list of federal programs because of the potential for large losses to taxpayers and long-standing internal control weaknesses. Since then, we have devoted significant attention to problems with pension plans and PBGC. In December 1992, as part of a series of reports dealing with high-risk areas, we reported our concerns about PBGC.[1]

In our view, successfully addressing the problems confronting PBGC involves management reforms, modification of the pension funding rules, and, possibly, changes in the insurance premium structure.

MANAGEMENT DEFICIENCIES WEAKEN PROGRAM ADMINISTRATION

The first challenge is better management of PBGC. Weaknesses in internal controls and financial systems have undermined PBGC's ability to administer the pension insurance program. We have been unable to audit PBGC's financial statements, primarily because we were unable to determine the reliability of its estimated liability for future benefits, which makes up more than 95 percent of its reported liabilities. Nobody can effectively monitor PBGC's financial condition without reliable financial statements.

PBGC also has serious problems with its premium accounting and collection processes. PBGC's efforts to identify and collect delinquent (unpaid) premiums, underpaid premiums, and related interest and penalties have been inadequate. PBGC has not made adequate attempts to collect delinquent premiums from large plans, and had not even attempted to identify or collect delinquent premiums from small plans. Moreover, PBGC normally had not used civil action to collect delinquent premiums.

A breakdown in PBGC's computerized premium accounting system was a major factor in some of these problems. PBGC's computerized system has not been fully operational since 1988, after PBGC attempted unsuccessfully to modify the system to handle variable premiums. Until recently, PBGC management had not paid sufficient attention to premium system improvement initiatives to modify the current system and procure a replacement system. As a result, PBGC has only partially restored premium accounting system operations.

PBGC management has developed a series of interim and long-term financial management initiatives and provided added resources to address these weaknesses. PBGC established a comprehensive management control review program that is designed to alert its managers to their responsibility for (1) establishing and maintaining internal controls and financial systems, (2) assessing their operating effectiveness, and (3) addressing weaknesses that are identified.

Over the last 2 years, PBGC has made substantial progress with its financial management initiatives and its management control program. Many of the initiatives are still underway and will require additional time and resources to fully address the weaknesses. One indication of PBGC's progress is reflected in our ongoing audit of PBGC's fiscal year 1992 financial statements. While we still have substantial audit work to perform, we currently believe that PBGC has made sufficient improvements to allow us to complete a full audit of its balance sheet. However, even with improved management, PBGC has limited ability to control its exposure to losses from underfunded plans.

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[1] High Risk Series: Pension Benefit Guaranty Corporation (GAO/HR-93-5, Dec. 1992).

PBGC THREATENED BY
LARGE LOSSES

PBGC's single-employer insurance fund[2] has had a deficit since its inception in 1974, and the deficit is growing. This deficit, which threatens PBGC's long-term viability, has resulted primarily from (1) the plans of bankrupt companies terminating without sufficient funds to pay guaranteed benefits and (2) a premium structure that does not provide enough revenue to cover losses.

PBGC currently has a positive cash flow--annual premium and asset incomes exceed its annual benefit obligations and administrative costs. However, longer-term prospects are unclear when considering PBGC's unfunded deficit.[3] This deficit was $2.5 billion in the single-employer fund at the end of fiscal year 1991.

When potential terminations of underfunded plans are considered, PBGC's financial condition looks worse. In December 1992, PBGC estimated that, as of December 31, 1991, $51 billion in underfunding existed in the ongoing plans it insures--a 28-percent increase from the previous year. About $40 billion of that underfunding was in single-employer plans, especially those in the automobile, steel, airline, and tire industries. PBGC estimated that about 30 percent of the single-employer underfunding, owed by financially troubled companies, constituted reasonably possible losses to PBGC.

In estimating underfunding, PBGC made adjustments to financial data reported for the plans because, in PBGC's view, plans' financial reports --prepared on the basis that plans are ongoing operations--do not reflect the financial conditions of plans when they terminate. Recent work by us supports PBGC's view.

Hidden liabilities increase claims

When PBGC takes over a plan, it calculates the value of the assets and liabilities it receives. The unfunded liability calculated by PBGC often exceeds that reported by the plan in its most recent annual filing with the Internal Revenue Service (IRS). GAO defines this difference as a hidden liability.

In a December 1992 report,[4] we studied 44 plans that terminated from 1986 to 1988, which accounted for 96 percent of the claims against PBGC for that period. PBGC determined that these plans had aggregate unfunded liabilities of $2.7 billion at termination. This was 58 percent higher than the $1.7 billion in unfunded liabilities reported by the 44 plans on their last, pretermination annual filings with IRS. Eighty percent of the nearly $1 billion in hidden liabilities was due to PBGC's higher estimate of plan liabilities caused by PBGC's use of different actuarial assumptions to value plan liabilities and the payment of shutdown or special early retirement benefits. Twenty percent of the hidden liabilities was due to PBGC's receipt of fewer assets than the plans reported. The lower asset levels were caused by the continued payment of benefits and the failure of plan sponsors to make required contributions.

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[2]PBGC administers two separate programs--one for single-employer plans, the other for multiemployer plans. The multiemployer plan insurance program had an accumulated surplus of $187 million as of 1991, according to PBGC.

[3]PBGC's deficit measures its assets against the present value of guaranteed benefits to participants in underfunded plans that have terminated or are expected to terminate in the near future.

[4]Pension Plans: Hidden Liabilities Increase Claims Against Government Insurance Program (GAO/HRD-93-7, Dec. 30, 1992).

PBGC uses three actuarial assumptions--interest rates, mortality rates, and retirement age--when calculating a plan's liabilities. The interest rate assumption had the greatest impact on liabilities. When GAO adjusted reported plan liabilities in the 44 plans to the generally lower interest rates used by PBGC at the plans' terminations, unfunded liabilities increased 31 percent.[5]

One reason for a difference in rates is that PBGC regularly adjusts its interest rates to reflect changes in the market price of private insurance companies' annuity contracts. Plan rates tend to be more stable over time because they represent the expected rate of return on plan assets over the long term.

Shutdown benefits, paid by some plans when companies close plants or downsize, are not prefunded and are not fully valued in the estimate of plan liabilities until they commence. If a plan terminates shortly after shutdown benefits originate, the sponsor will not have had time to fund them. Shutdown benefits cause a sudden increase in plan liabilities and drain plan assets. PBGC estimates that more than 25 percent of its current deficit may be attributable to shutdown benefits from steel industry plans. Shutdown benefits continue to pose a threat to PBGC because a large portion of its current exposure is from plans with shutdown-type benefit provisions in the steel, automobile, and tire and rubber industries.

The assets of the 44 plans GAO reviewed declined by $200 million between their last IRS filing and termination, primarily because of benefit payments. Also, sponsors, experiencing financial difficulties, often failed to make required contributions to their pension plans. The reduction in assets would have been $45 million less if sponsors had made all minimum required contributions.

Even though PBGC is aware of the hidden liability problem and attempts to estimate its exposure by adjusting reported plan liabilities to its own interest rate, it has few tools to control its exposure to plans with hidden liabilities.

PBGC's LIMITED ABILITY TO DEAL WITH RISK

Because the pensions of plan participants are insured by PBGC, plan sponsors experiencing financial difficulties sometimes take actions that increase the exposure and risk to PBGC. They know that, if the plan terminates before these benefits are fully funded, PBGC will assume the responsibility for paying guaranteed benefits, within certain limits, including a 5-year phase-in of benefit increases.

At present, PBGC's only means of restricting its losses in these cases are to persuade the sponsor to better fund the plan or to terminate the plan, which PBGC can do only in limited circumstances. Even when PBGC can do so, it tries to avoid terminating a plan because such action is onerous to all involved. For example, PBGC incurs a claim that it will have to pay, workers stop accruing benefits, retirees may have their benefits reduced, and the sponsor may be forced into bankruptcy if not already there.

Program Design Contributes to risk

Two design features of the Employee Retirement Income Security Act (ERISA)--the premium structure and minimum funding standards--also limit PBGC's ability to control the risks these underfunded plans pose. The premiums PBGC collects insure a plan against any shortfall, up to the maximum guarantee times the number of plan

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[5] Calculated plan liabilities rise when interest rate assumptions decline and fall when interest rates rise.

participants, no matter how large. Well-funded plans are subsidizing underfunded plans through the premium structure. For years, the single-employer plan annual premium was a fixed amount for each plan participant, regardless of the plan's funded status. To better reflect the risk PBGC faces from underfunded plans, the annual premium was restructured in 1987. Currently, each plan pays $19 per participant; underfunded plans pay an additional variable premium of $9 for each $1,000 of unfunded vested benefits per participant. The combined premium has a ceiling of $72 per person. The fixed premium probably overcharges well-funded plans for the risk PBGC assumes in insuring them; the capped variable premium undercharges underfunded plans for this risk.

Another challenge facing Congress is better funding of insured pensions. ERISA's minimum funding standards do not ensure that all plan sponsors will make sufficient plan contributions to pay promised benefits upon termination. For example, plans that had unfunded liabilities when ERISA was enacted may amortize the unfunded amount over a 40-year period; benefit increases can be amortized over a 30-year period. However, plan sponsors may increase benefits even if the existing benefits are not fully funded. As a result, many of the plans that were underfunded when ERISA was enacted remain underfunded. The Congress has enacted legislation to strengthen the minimum funding standards, most recently in 1987. However, these changes may not be enough to ensure PBGC's long-term financial viability.

We are currently assessing the impact of the 1987 changes on plan funding. In the meantime, work we are currently performing for your Subcommittee shows that some underfunded plans are increasing their benefits and becoming more underfunded. In addition, overfunded plans are becoming less well funded.

Benefit Increases by Underfunded Plans

To address the issue of benefit increases in underfunded plans, you requested that we look at 8 companies on PBGC's list of the 50 companies with the largest underfunded pension plans to determine the extent of their underfunding, whether they recently increased benefits, and how any increases were funded. The eight companies sponsoring the plans we analyzed are in the auto, airline, steel, and tire and rubber industries.

Our work is not yet completed, and we have not discussed our findings with the companies involved. We need to obtain a better understanding of the funding dynamics and the nature of the benefit increases. However, our results to date, which are based on the companies' data,[6] show that some significantly underfunded plans provided benefit increases that further increased their liability.

In plan year 1991, or 1990 for some plans not on a calendar year basis, the eight companies had 68 pension plans,[7] of which 33 were overfunded and 35 were underfunded. The overfunded plans had benefit liabilities of $21.4 billion and assets of $24.2 billion. The underfunded plans were underfunded by about $10.7 billion, with

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[6]PBGC's top 50 list is based on company data adjusted by PBGC. Generally PBGC's adjustments, especially its use of the PBGC interest rate, rather than a plan's interest rate, would result in a significantly higher liability than a plan reports. In addition, individual plan data were often not available to PBGC, which reported underfunded plans by company using aggregate data on underfunded plans from the plan sponsors' financial statements.

[7]Some plans do not report on a calendar year basis. Our 1991 data include 1990 data, which are the most recent available for such plans. Also, we excluded four relatively small pension plans that had not been in existence during both 1990 and 1991 and three large plans that were atypical.

liabilities of $31.8 billion and assets of $21.1 billion. For 49 of the 68 plans, the funding ratio--the ratio of assets to liabilities--had declined from the prior year. In other words, the overfunded plans had less surplus than they had before or became underfunded, and the underfunded plans became more underfunded.

Eighteen of the 35 underfunded plans had increased benefits in 1991. While some of the increases were relatively small, others were substantial in relation to the plans' unfunded liability and the increases in their accrued liability. For example, the benefit increases for one plan were equal to 59 percent of its unfunded liability and 54 percent of its increase in accrued liability.

Overall, the benefit increases by the 18 plans were about $2.2 billion, which was about 20 percent of the amount by which these plans were underfunded for 1991 and 6.8 percent of the 1991 accrued liability. Benefit increases accounted for about 39 percent of the increase in unfunded liabilities between 1990 and 1991. Though this is significant, we are also looking into other factors that influence liability growth and will be reporting on this in the future.

We also analyzed benefit increases over a 3-year period and found that 10 additional underfunded plans had benefit increases, though benefit increases in 1991 were higher than in other recent years. In total, benefit increases averaged $1.2 billion a year for the 28 of the 35 underfunded plans that increased benefits at least once during the 3-year period 1989-91.

The attachment shows the extent of underfunding for underfunded plans and the amount of benefit increases that such plans granted in 1991. We have not identified the plans, and we have combined data from two large plans. We did this because the Single-Employer Pension Plan Amendments Act of 1986 prohibit us from disclosing the identity of any individual or employer in making any information obtained under the act available to the public. We have identified the plans and the companies sponsoring them to your office.

CONCLUSIONS AND ACTIONS NEEDED

As long as pension plan underfunding persists, the pension insurance program and plan participants' benefits are at risk. We believe this is the time--while PBGC still has a positive cash flow--to develop solutions to better fund pension promises. We support more effective funding standards for defined benefit pension plans. Reducing underfunding would limit PBGC's future exposure and appropriately target the greatest threat confronting it--underfunded pension plans. Although strengthened funding standards would increase the federal deficit in the short run, because pension contributions are a tax-deductible business expense, it is a necessary step to avoid potentially significant future costs.

In addition, the Congress should consider whether the overall premium ceiling and existing variable premium rate best reflect the risk to PBGC. Raising premiums, by making the variable rate premium more risk-related would reduce PBGC's deficit. The Congress should first focus on the premiums paid by underfunded plans because these plans pose the greatest threat to the program.

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Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Subcommittee members may have.

UNDERFUNDED PLANS AND BENEFIT INCREASES (IN THOUSANDS)

Plan	1990 underfunding	Benefit increase	1991 underfunding
1	$9,150	$8,153	$24,498
2	5,565	368	13,393
3	152,938	919	207,243
4	1,659	--	1,409
5	1,211	--	1,756
6	313,200	29,043	486,975
7	262,352	41,767	330,989
8	110,813	21,922	155,229
9	31,074	11,403	51,312
10	14,503	3,512	21,750
11	2,743	26	2,990
12	274	12	1,362
13	215	43	460
14	105	--	149
15	(596)[1]	--	1,961
16	(939)[1]	--	1,156
17	(1,049)[1]	2,489	8,569
18	9,061	--	8,607
19	1,467	--	1,472
20	1,117	--	819
21	853	--	781
22	720	--	632
23	707	--	802
24	(189)[1]	100	75
25	(1,761)[1]	--	204
26	3,363	4,695	45,871
27	110,481	--	60,385
28	26,421	449	12,854
29	4,011	--	4,177
30	2,789	--	1,454
31	1,814	--	1,551
32	67,123	--	92,058
33	(7,956)[1]	93,746	158,262
Two large plans	3,999,362	1,933,302	8,966,904
Totals	$5,122,601	$2,151,949	$10,668,109

[1]Plan was overfunded by this amount in 1990.

Mr. KLECZKA. Let's start off with the questions. We are checking on the votes now. Let me first ask Mr. Lockhart, as the former Executive at the PBGC—we were told or we read in the Washington Post recently that the Board of Directors has met only once in the last 10 years.

Could you respond to that for the committee?

Mr. LOCKHART. That wasn't quite accurate. They met once in person in December of 1990. We had two meetings late last year on the telephone. We also conduct an awful lot of business—the Board of Directors has three Cabinet Secretaries and it is very hard to get schedules together, so a lot of business has been conducted by resolutions where effectively they all sign off.

As to in-person meetings, there was only one in the last 10 years, but we had several last year at the end of the year. The other way business is conducted is we have quarterly meetings with representatives at the Under Secretary or Assistant Secretary levels.

Mr. KLECZKA. Over the years, GAO has looked at the books of the PBGC and has yet to sign off on an audit. We are told by GAO that will be completed some time later this year. What is your idea of the timeframe?

Mr. LOCKHART. When I arrived at PBGC in 1989, I looked at the accounts and saw that there was no opinion and coming from the corporate world that was a problem, so we asked GAO to come in and audit our 1990 accounts. We work closely with GAO. Our Inspector General at the PBGC has done some reports. And have had the assistance of significant outside accounting and consulting expertise. We have made, I think, dramatic progress at the agency. I am hopeful that the results of the audit will say that the accounts are auditable this year.

We have made progress in all three of the key areas, the internal controls, our future benefit liabilities and our premium systems.

Mr. KLECZKA. Dr. Reischauer, we have heard the testimony again from GAO indicating that for the eight companies they audited, we found that even though an underfunding problem existed in 1990, the corporations involved provided large benefit increases in their pension plan only to increase that liability. It seems to me that employers in lieu of giving pay increases or increased insurance benefits are reverting to what I call a hollow promise, that of "we will give it to you in a pension increase," knowing that when rough times hit the PBGC is sitting there to provide some corporate welfare and make good on their promises. In the savings and loan problem, even though savings and accounts were insured up to $100,000, in many instances taxpayers were reimbursed the full amount even though it was above and beyond our obligation and liability. What would you suggest to stop the benefit increases which we view especially for the top 50 companies which are so underfunded to stop giving their employees a hollow promise so they don't end up like Mr. Clarke, and make sure those liabilities are backed up?

Mr. REISCHAUER. As you point out, it is not a hollow promise because in all likelihood, the American taxpayer is standing behind this promise, and that is why workers are willing to accept increased benefit promises in lieu of wage increases. There are a number of ways to reduce the moral hazards associated with this

program, which cause behavioral responses of the kind you have just mentioned. One, of course, is to force companies that have large unfunded liabilities to pay higher premiums—to make them less willing to go down that road.

Mr. KLECZKA. Higher than the current $52? Because it seems to me if an employer had a choice of providing more funding for its pension plan versus $52, $52 is a lot cheaper.

Mr. REISCHAUER. The premium is $19 per plan participant plus $9 per $1,000 of unfunded liability. The premium has a cap of $72 per participant, however. If your unfunded liabilities put you above the cap, the additional underfunding is, in effect, free. Changing the premium structure would be one way to encourage firms to reduce their unfunded liabilities. Another way would be to require that further pension promises by significantly underfunded plans be backed up with some form of collateral, as the chairman's bill has suggested. So one can go about shifting the incentive structure in a number of ways. Of course, another approach that would put the onus back on the employee would be to provide a "haircut," or benefit reductions. But this would, in a sense, undermine the very nature of the program as it stands now.

Mr. KLECZKA. Thank you very much.

Mr. Houghton.

Mr. HOUGHTON. Thank you. Gentlemen, this is a question to Mr. Delfico, but maybe you all would like to chime in. We all stand on alert and we understand some of the trends. We certainly don't want to have this thing go over the cliff and hurt the American people. Yet at the same time, I have to ask you how serious this problem is. Here you have a defined benefit pension system that is supposed to have assets of $1.3 trillion and you have liabilities of $900 billion. Doesn't sound too bad. You don't have any cash flow problems. Furthermore, when you compare that to Social Security, Federal employees retirement system, military retirement system, and the railroad retirement fund, it is probably better off than they are. I know we have problems and some of these disciplines which you suggest are good. Yet at the same time, to put this in perspective with the dimension of the problem here, tell me a bit about that because I am a bit confused.

Mr. DELFICO. I think the point that we are trying to make here is that PBGC's problem is with underfunded plans. It is not the problem that the deficit is $2.5 or $2.7 billion but the fact that PBGC is being threatened by a large group of underfunded plans of companies that are on the verge of bankruptcy. The future looks bleak if these plans terminate. Now is the time to take a look at the underfunded plans rather than focusing on the size of the deficit, and whether it is comparable to the savings and loan situation. The work we did for this committee was enlightening. It appears to us, as stated in my testimony, that underfunded plans are getting more underfunded. Something has to be done about this. That is why we think we need stronger funding rules.

Mr. HOUGHTON. I don't disagree with you. I am trying to figure out how serious is the problem that certain disciplines have to be superimposed upon people. Kimberly Clarke may be underfunded but it is a very strong company. Chrysler may be coming up in

pretty good shape—we are interested in taxpayers and what impact it is going to have. Is it a very, very serious problem?

Mr. DELFICO. I would say that it is a serious problem that you really have to watch. It can get away from you if you ignore it. It is a problem that may require serious attention by this committee in the near future particularly regarding premiums. No one knows whether the premium income can cover benefits in future years. I don't think anybody has a precise date when that crossover occurs but if any of the large pension funds on the high-risk list terminate, you may have to consider a premium increase to cover losses.

Mr. REISCHAUER. I would like to concur with that and also say that this is not a massive problem that is looming over us but a creeping one. Eventually, the American taxpayer is going to have to pick up the tab for it because of the way the program is structured. The evidence that GAO has accumulated suggests that there is a deficit here that is going to have to be picked up by somebody. The bad news is that as we look over time, that deficit seems to be growing. In addition, we have a system that allows the healthy, stable, fully funded plan to exit. They can terminate their plans and thus eliminate the need to pay premiums that are in excess of the benefits they receive from this guarantee.

To the extent that the financial condition of this program deteriorates, you are going to see an increasing number of firms leaving the system, which is going to result in a smaller premium base. When that premium base shrinks sufficiently, there is really no other course but to turn to the American taxpayer, as was the case in the savings and loan bailout, or to deny to many, such as Mr. Clarke, the benefits that they expected to receive.

Mr HOUGHTON. I have just got one other point and I thank you for that answer. It is not quite on that subject. In 1988, Mr. Delfico, you were before this committee and talking about the pension fund investments. The churning, the in and out, the wisdom of some of the investments which has a tremendous implication here on the underfunding—do you have any comments you would like to make on that?

Mr. DELFICO. The report in 1988 had to do with the stock market crash of 1987. We attempted to determine whether plans had lost significant amounts of assets during the 1987 stock market crash. Our finding, at that time, was that they recovered fairly well. To our knowledge, plans are doing moderately well as far as investments are concerned. I think the Department of Labor and IRS have been looking into this. To my knowledge, we haven't seen anything that would alarm us with regard to their assets.

Mr. LOCKHART. If I can make a point on that and following up on the seriousness of the situation. One of the things that has happened over the last decade is pension plans have very good returns in their bond and stock portfolios, yet the underfunding is continuing to go up. That has to be of concern because markets don't go up forever, and if we start seeing markets going down, the problem which is very serious could get much worse. One other point that I think is critical here is Mr. Clarke is one of many that when a plan terminates it just doesn't hurt the premium payers, it hurts individuals and some of them very significantly. We see on average 10 to 20 percent of the people in these plans that have cutbacks of

some size, bigger than we heard today, sometimes 50 percent. It is not just a problem for the PBGC and the taxpayer. There are individuals that are suffering because their companies are not funding their plans well.

Mr. KLECZKA. You indicated that pension plans are seeing decent returns on their investments; however, liabilities keep increasing. Is that the result of increasing benefits?

Mr. LOCKHART. There are two reasons that liabilities are increasing. One is increasing benefits. We saw that in the last round of negotiations in the auto, steel, and rubber industries, where we calculated almost a $9 billion increase in benefits were negotiated. The other reason, which is a plus and minus, is that interest rates have fallen and liabilities are discounted so that as interest rates come down the liabilities go up. Of course there is an offset because usually they hold bonds and they go up on the asset side.

Mr. KLECZKA. For the industry involved in the $9 billion increase in benefits, these are the same industries who entered the period underfunded?

Mr. LOCKHART. They have been historically the problem industries in the PBGC since the day it was founded and they continue to increase their benefits significantly.

Mr. KLECZKA. Thank you.

Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. Mr. Lockhart. Last Friday the Washington Post reported a growing movement within the administration to implement President Clinton's campaign proposal to tap the Nation's pension funds for the infrastructure projects. The proposal calls for pension plans to invest $30 billion in public works projects. In your estimation, how would a program such as this affect the financial condition of the pension system?

Mr. LOCKHART. This is a personal opinion, not being a member of the administration. My view is that such a program would have to be done extremely carefully. It scares me especially when they talk about creating another insurance company, a Government corporation to help guarantee things. Having run a Government insurance company for 4 years that after 18 years it is still not right, it would scare me to create another Government insurance company. As to the pension system itself, if the insurance company works then in theory they may not be any harm to the pension system.

Mr. REISCHAUER. Could I add a few words on that? Of course, we do not know the details of this plan, but I do not think there is any evidence that a lack of financial resources is what is holding back infrastructure development in America. State and local governments can go to the market and borrow, and rates are lower than they have been in many years. The real issue here is who is going to pay the interest and repay the principal on that debt. What we are talking about here is either providing a direct Government subsidy in addition to the subsidy that already exists—because State and local governments are able to borrow in the tax-free markets—or reducing the return that the pension plans receive on their investments.

The reason pension plans are not particularly interested in State and local government securities, obviously, is because as tax-exempt entities, they are not interested in tax-exempt income. We

really have a difficult situation here that fundamentally comes down to this: Do we as a society want to subsidize additional infrastructure spending by State and local governments, and if we do, who should pay for it? Should the subsidy come from the Federal Government explicitly? Should it come in some surreptitious form through various kinds of guarantees from the Federal Government? Or should it be taken out of pensions?

Mr. HERGER. I think we could gather from that that with a pension program that is already hurting, to me the thought of going into this further and borrowing an additional $30 billion on top of the problems we already have certainly would give me a great deal of concern.

Mr. REISCHAUER. It is also worth noting that this money is not under a mattress somewhere. It is now being invested in productive private-sector investment activities. If it were diverted into State and local infrastructure spending, one would have to ask, is the productivity potential there greater than it is in the investments that would have been made otherwise in the private sector?

Mr. HERGER. I believe this is a very important question. I represent a very rural district in northern California which has a lot of roads that would love a lot of infrastructure, so it would like to have use of these funds. But when we look at the overall picture of how this money is going to be paid back, again it would seem to me we are putting more of a stress on an already overstressed system that is unable to come up with the funds. I appreciate your testimony.

Just one other point—again, Mr. Lockhart. You recently did a study, I understand, on eight major corporations two of which were automobile companies—are you familiar with that?

Mr. LOCKHART. Are you referring to the GAO?

Mr. HERGER. Yes. I am sorry. Mr. Delfico, just recently, is it a fact that these two automobile companies together showed a $4.7 billion in pension underfunding in 1990 and still granted $2 billion in new pension benefits in 1991?

Mr. DELFICO. I think we have noted in the attachment to our testimony that there were a number of companies that did that, and if you look at the bottom you will notice the totals that refer to that. Yes there were totals of about $2.1 billion in benefits.

Mr. HERGER. That was a total of all eight, is that right, 2.15?

Mr. DELFICO. Right.

Mr. HERGER. Yet we showed even more pension benefits were being granted at the same time that we were showing deficits, is that correct?

Mr. DELFICO. Yes, that is correct.

Mr. HERGER. Does this give you concern?

Mr. DELFICO. It gives me some concern, particularly in the extreme cases where the benefit increases far exceeded the normal increases in liabilities. In one plan, as I noted in the testimony, it was quite large. What was more striking was that overfunded plans became underfunded during that time period. So it is not just the underfunded plans you have to worry about, it is the overfunded plans, that we tend to forget about, that are becoming underfunded.

Mr. KLECZKA. Mr. Pickle.

Chairman PICKLE. Thank you, Mr. Kleczka. I want to follow through at this point on a question Mr. Herger raised with respect to these studies we asked you to make, Mr. Delfico. I am going to quote figures that we have been given based on the information you received by going directly to the companies to get the status of their pension programs. This is not confidential tax information at all; this is information that you got from the companies which others can get. It was also filed with the IRS. Let me take some examples.

You examined one tire company with two plans. At the end of 1990, they had a total of $14.7 million underfunded plan liabilities. Those two little plans were underfunded by $14.7 million. During 1991 they gave benefit increases of $8.5 million. That particular company's plans were underfunded by $37.8 million at the end of 1991. In 1 year's time they went from $14 million to in effect $37 million of underfunding.

Secondly, there is another tire company which had three plans, but their total underfunding was $155.8 million. During 1991 they gave benefit increases to their plans of $919,000 and now they have underfunded plan liabilities at the end of 1991 of $210.4 million. Next is an automobile company with several plans. They started off at the end of 1990 with a total of $2.3 billion of underfunding in all their 12 or 13 plans. Then during 1991 they gave benefit increases of $529 million. They now have an unfunded liability at the end of 1991 of $3.3 billion. They have gone from $2.3 billion to $3.3 billion in 1 year's time.

I take one more example of another automobile company. They started off with underfunding of $2.4 billion at the end of 1990. They gave $1.5 billion in benefits during 1991. And they have ended up now with an unfunded liability of $6.6 billion. They have gone from 2.4 up to 6.6. The interesting thing to me is that in this particular case they were at $2.4 billion of underfunding but they gave benefits of $1.5 billion in that one company.

Now, we could go on. I have further examples of problems with steel and airline companies. I find one airline was underfunded in 1990 at $75 million but they gave out during the year $93 million in benefits even though they were underfunded $75 billion. So their underfunded liability is $250 million. I mention these figures and they are factual because they have come from the companies themselves and they are based on information obtainable through examination of 5500. It seems to me that it is clear evidence that the plans are underfunded and it is growing, and even the overfunded plans are becoming less overfunded. So do these figures I give you, do you question them? I guess you don't question them, because they are your figures.

Mr. DELFICO. No, sir, I don't question them.

Chairman PICKLE. Do you concur generally with my analysis?

Mr. DELFICO. Your analysis is correct Mr. Chairman. We have noted these changes in the plans during those two time periods.

Mr. KLECZKA. Will the chairman yield? So we don't have any confusion, let's go back to the auto example used by the Chair wherein the company left 1990 with an unfunded liability of $2.4 billion, increased benefits to the tune of $1.5 billion and ended up with a $6.6 billion underfunding amount for 1991. That does not

add. Could you indicate to the committee what the factors are that increased the unfunded liability?

Mr. Delfico. There are a number of factors. The benefit increases accounted for about 40 percent of the growth in unfunded liabilities across the board. Part of the rest could be accounted for by actuarial changes, losses in their investments that could cause an increase in their liabilities. In addition, we are concerned about the fact that their contributions were not enough to make a difference in reducing their liability. This goes to the heart of the legislation that we are talking about today, making those contributions adequate enough so that the liability will be decreased.

Mr. Kleczka. Thank you, Mr. Chairman.

Chairman Pickle I yield back my time, but I want to come back to Mr. Delfico and Mr. Lockhart for other questions.

Mr. Kleczka. Mr. Hancock.

Mr. Hancock. A couple of brief questions. A few years ago a situation occurred on the west coast with a life insurance company in which several companies had closed their pension plans and as an agreement with their employees bought annuities in that company. I am sure you are familiar with the name, and I believe it is all right to mention the name—Executive Life. They had a real problem and a lot of employees suffered. It was rumored at one time that the Pension Benefit Guaranty Corporation was going to look at picking up those annuities even though it would appear to be there was no liability on their part because the plan had properly terminated. Did we end up getting involved in picking up the liabilities under those annuities?

Mr. Delfico. PBGC did not pick up the liabilities from those annuities. As you have stated, they were not insured so they were not picked up by the Federal Government. The State insurance association in California, I think, is trying to work out a settlement on that.

Mr. Hancock. I was curious. I know they were called upon because when something like that occurs, the first place they look is up here, the fact we have such a big budget surplus is the Federal Government can afford to pick it up.

Dr. Reischauer, you commented that one of the problems of looking at the Pension Benefit Guaranty Corporation in the future years was the fact that fully funded plans now are taking a serious look at whether they want to continue to pay premiums into the Pension Benefit Guaranty Corporation. If they are fully funded they can terminate those qualified pension plans set up under the qualified pension plan laws, convert that money on an optional basis to a prototype purchase plan. It could save their retirees a lot of money, because the premiums would otherwise go to the Pension Benefit Guaranty Corporation when it accrued to the employees in their individual accounts. Am I correct here?

Mr. Reischauer. Yes. We cannot look upon the well-funded plans as a cash cow that later we will be able to tap to pay for the accumulated deficits. It will be in the interests of both companies and their workers for firms to terminate their defined-benefit plans an to start a different form of pension.

Mr. Hancock. Which means they would no longer be contributing into the insurance funds?

Mr. REISCHAUER. Correct.

Mr. HANCOCK. As a pension fund adviser wouldn't it be logical to advise that company to terminate their plans?

Mr. REISCHAUER. There is a benefit that even a fully funded plan receives from having the assurance of the PBGC guarantee. As a result, plans and companies are continually evaluating whether this benefit is worth the price they are being asked to pay. And there are costs to moving from their existing defined-benefit plan to a different system. It involves continual judgments.

Mr. HANCOCK. I agree with that. Especially when you are looking at maybe an employer that has 25,000, 30,000, 40,000 employees. But what if you have 25 employees under a plan like that? The administrative costs you would have to pay because of the rule changes every year, plus the pension benefits are significant. How many qualified pension plans have been terminated that were fully funded because they wanted to escape the administrative overhead costs. We want to guarantee people their retirement money, but we also want to guarantee them with a plan too.

Mr. REISCHAUER. That has been the trend.

Mr. LOCKHART. We are losing about 10 percent of the plans we insure every year. They are terminating in a standard termination oftentimes because the administrative cost is too much, maybe the company is going out of business or maybe it is merging. We are down to now 67,000 insured plans which is probably 50 percent of our peak insured companies. So there is a significant trend; you are right.

Mr. HANCOCK. Can you tell me how many of those that are down are converting to the profit sharing and money purchase plans rather than going out of business?

Mr. LOCKHART. We don't have statistics on the overall universe but we keep statistics for the ones that revert—I would say that about half of them are going to defined contribution plans and the rest may not be going to anything, which is even more worrisome. They are leaving the pension system entirely.

Mr. HANCOCK. Thank you very much. Thank you, Mr. Chairman.

Mr. KLECZKA. Mr. Santorum.

Mr. SANTORUM. There is a point made by Mr. Delfico that I want to follow up with Mr. Reischauer. If we require an increase in minimum contributions and require more money to be put in pension funds by corporations, the effect on us in D.C., on our budget deficit is that the more we require them to put in the pension fund that means the less they will pay in taxes to the Federal Government. So by passing legislation to require more money to go into pension funds, which is not going to be a revenue benefit to the Federal Government, we are going to increase the Federal budget deficit. Do you in your calculations put any savings in the calculation for increasing the requirements of these other plans?

Mr. REISCHAUER. For reducing the longrun liability to the Federal Government, the answer is no. That is one of the perverse aspects of the current budgetary treatment of this program. We have put it on the pay-as-you-go scorecard, which leads to a series of very perverse incentives. If you increase premiums and the increase produced an inflow of cash into PBGC, you could use that

money to increase other mandatory spending—which would also be a perverse result.

If you took the step that you are suggesting—to increase funding requirements—you reduce tax revenues; you would then be scored with a revenue loss, and you would have to make it up some other way. So the budgetary treatment is a disincentive to adopt policy like that.

Mr. SANTORUM. Is it the Budget Act that requires you to do that or is it your scoring of how that transaction works that requires us to do that?

Mr. REISCHAUER. This is the way we score this type of activity. Historically, the Treasury and OMB have scored it that way as well.

Mr. SANTORUM. So it is a scoring model?

Mr. REISCHAUER. A scoring practice, yes.

Mr. SANTORUM. You are basically admitting to me that it is an incorrect practice. You seemed to be smirking when you were answering the question.

Mr. REISCHAUER. I am not smirking. When you are trying to decide on scoring procedures, you have to set up rules that will govern all Federal activities. You cannot say "I like this one policy effect. In the long run, I think it will benefit the Federal Government, and therefore we should not count it." An example would be a case in which someone comes to you and says "We know that if we increase funding for the special supplemental food program for women, infants, and children (WIC), in the long run it will reduce poverty and improve the health of American adults—because they will have grown up in a healthy environment—so let's not score that as a cost." There are many areas in which Federal spending or revenue action taken now reduces or increases the potential liability of the Federal Government in the future. It would be wrong for an agency such as CBO or OMB to pick and choose. We are suggesting that if the Congress wants to follow this path, the right way to do it is to go into the Budget Enforcement Act and, as we did with the deposit insurance accounts, remove the PBGC account from the pay-as-you-go scorecard.

Mr. SANTORUM. You made the point, a point that is made often around here, that the way we score things creates a very short-term focus in this place and that we don't look at long-term benefits. As a result, we get penalized for looking at long-term benefits for short-term expenditures. There was something the Chairman was going through that I thought was interesting. This was something Mr. Kleczka talked about which made me upset when he told me the story of what happened in his community. It was that the funding of wage plans seems to be much more out of whack and underfunded than the funding of salaried pension plans. What a lot of corporations are doing is their upper and middle management have very healthy funding and for their wage plans very much underfunding. Is that a common practice number one, and number two, I haven't heard any suggestions as to how to address that problem if you see it as a problem, and I do.

Mr. DELFICO. In the data we have, we saw the same phenomenon. In total, what we found was that participants in a bargained plan

in our sample, and it is a biased sample, stood a 93-percent chance of being an underfunded plan.

Mr. SANTORUM. You say it is a biased plan, but it is only biased to the point of these are grossly underfunded plans and the ones that are most troubled.

Mr. DELFICO. We didn't randomly pick them from the universe. We selected from the subsample of underfunded plans. You have a 93 percent chance of being in an underfunded plan if you are in a bargained plan. If you are in a nonbargained plan there is an 18-percent chance. Not all bargained plans are wage plans. Some may be salaried plans. That gives you indication of the differences we found. I think this is supported by other data that we have from PBGC.

Mr. SANTORUM. If the chairman would permit me, I haven't seen anybody suggest that this is a problem that needs to be addressed and how we go about addressing it.

Mr. LOCKHART. It is a problem at the agency. The numbers we have seen in a study done by the IRS is that the average salaried plan is funded at about 140 percent, the average flat benefit collectively bargained plan is about 75 percent. It is inherent in the plan design that these plans are designed to have benefit increases periodically and never get caught up. They are getting further and further behind. The funding rules that the chairman has in his proposal and PBGC had last year are designed to hit these underfunded plans to make them catch up. So the rules that are being proposed are designed for this problem of the flat benefit union plans and trying to force the companies to better fund the plans.

Mr. SANTORUM. But you are not really doing anything to equalize. You are forcing them to move up, but you are not asking us—and I don't know whether you are suggesting we should contemplate requiring those plans that are overfunded to contribute to those that are underfunded. Is that a possibility?

Mr. LOCKHART. We have never proposed that and I would not be in favor of it.

Mr. SANTORUM. Why?

Mr. LOCKHART. I don't like the idea of limiting any pension contribution, if you will, and if you start limiting it in the salary plans we may get more and more of the salaried plans that become in trouble. The only plan that terminated in LTV was a salaried plan. Our proposal is to get the flat benefit plans funded up and the companies can make their resource decision. If you increase the rules enough on the flat benefit plans they are going to automatically not put as much into their salaried plans and put more into the flat benefit plans.

Mr. SANTORUM. Thank you.

Chairman PICKLE. Two general questions. I read to you the figures you submitted to us to show how many of these companies, particularly in certain lines of work, are going deeper and deeper in debt and further and further behind in their pensions. I don't think anybody argues that that is a fact. Now the question is what do we do about it. In Texas, we have an old saying that says if you look around and find that you have dug yourself into a hole and you wonder what you are going to do about it, the first thing you do is stop digging. The legislation and proposal made may not cure

the problem, but at least might keep us from going further in the hole, and it is a serious matter. And we can't toss it off; at least I don't think we should. We have to try to address it. I remember in lighter moments, I think it was a Senator from Texas who was in a fight with the KKK, and he said when that fellow dies, we are going to bury him head first, so the harder and longer he dug the sooner he gets to his eternal resting place.

We are not at a point where we are going to try to put anybody in the grave, but we are at a point where I think serious consideration has to be given to what we are going to do and how do we go about it. We are looking for some kind of direction and we have introduced legislation. Some questions have been raised about whether we are doing the right thing, so I am going to ask first, Mr. Delfico—all three of you, I think you can answer some of these questions yes or no. I am not looking for a speech. I want a general response.

Let me ask you first, I know you have already said that you share our concerns and your testimony is excellent; you say that it is a bad situation and we ought to do something about it. Some have said they are very concerned because there are serious shortcomings in PBGC's operations, particularly in the field of internal management and accounting control, and they have suggested that what we ought to do is hold off from any action until we get more information and we can see what should we do and where are the facts.

Would any of you before me now recommend delaying legislative action to control these risks to PBGC's financial condition based on this one problem—we don't have enough information. Should we delay and not do anything?

Mr. DELFICO. Being the ones who have raised the issue about the unauditable financial statements, I do not think you should delay developing legislation.

Mr. LOCKHART. You shouldn't delay. You should act as soon as possible.

Mr. REISCHAUER. No, you should not delay.

Chairman PICKLE. A second reason that has been extended that we maybe ought to have a delay, was that the PBGC was not facing an immediate inability to pay benefits to participants in a failed pension plan. To be more specific, PBGC has assets of about $6 billion and liabilities of nearly $9 billion. That means it has a negative net worth of $2.7 billion plus or minus and it is technically insolvent. However, it could continue to pay benefits when due for perhaps several years more.

So I want to ask each one of you as a panel, in your review of the financial conditions of the PBGC, are you satisfied that the PBGC has a current deficit of $2.7 billion and that this deficit has been growing larger in recent years? Do all of you answer yes?

Mr. DELFICO. More or less yes.

Mr. LOCKHART. My answer is yes. I have signed off on those numbers.

Mr. REISCHAUER. He signed off on them, so I will agree to them.

Chairman PICKLE. Next question and I am trying to get a general reaction here—are you satisfied that the contingent liability that PBGC is accruing as a result of pension underfunding by plan

sponsors is also steadily increasing? The liabilities are increasing. Is there any question about that?

Mr. DELFICO. I think on the average you will see an increasing trend.

Chairman PICKLE. Is there any reason to believe that in the absence of legislative action, either of these trends will reverse? Will they just work them out by themselves, or let me put it more bluntly: If we do nothing, is there reason to think that this problem will go away?

Mr. REISCHAUER. Highly unlikely.

Mr. DELFICO. Yes, it is unlikely.

Mr. LOCKHART. I would agree. The problem is getting worse and no action will just increase the problem.

Chairman PICKLE. Isn't the situation of the PBGC today unpleasantly similar to that of the FSLIC in the late 1970s and the early 1980s, and shouldn't we be concerned that the longer we wait to act the greater will be the damage to the defined pension system?

Mr. DELFICO. I would have one concern with that because I think they are two different situations. I think the situation with the savings and loan and the PBGC situation are different, but I do think there are serious problems with PBGC.

Chairman PICKLE. I have asked you these questions. A general question—I have proposed legislation and we are looking for suggestions. You know what I have proposed. Many of you said we ought to have legislation. I am not asking would you endorse my legislation, but is it along the line that you think we ought to address this question, or do you have other suggestions, or would you submit other suggestions or information?

Mr. DELFICO. We think they are along the lines we have been advocating for for quite some time. When we have other suggestions we will clearly talk to you or your staff about them.

Mr. LOCKHART. They are certainly very much along the lines of what we have been pushing. The one piece missing that we think is still critical is in the bankruptcy area. We think we need to have some solidified bankruptcy priorities to protect pensions.

Mr. REISCHAUER. The elements of your bill are among those that we have included in our report as effective measures to reduce PBGC's deficit. However, I would add that I think it is important that we change the structure of the system to provide some assurance that when things go sour in this program, corrective action is taken rapidly and automatically—rather than using an approach in which the Congress periodically comes back and goes through a long, laborious process to change the legislation.

Chairman PICKLE. I noted that one or maybe two of you have suggested there is some reason to say we might consider a premium increase. I think there is a general agreement among most people that the premiums we charge are very small and too small based on the risk that is involved, but we also are faced with a balancing problem. If you keep raising the premium on companies, though they are solvent, at some point they are going to say this is too much and I am going to get out of the system, particularly if they see some of the big boys digging themselves deeper and deeper in the hole and relying on the Federal Government. So some people

may say I will get out of the Federal program. That is a real threat.

Other things may be coming up. During the hearings, there was a question raised about whether we ought to look into the problem of insuring investments by these pension plans. We don't know what the answer is to that. We certainly think that each pension plan should make all the money they can and that is what they have done. We also think we have reached the point where the potential investment control that those funds have in the economic market is getting so large that probably we ought to look at that. Similarly, I think we are going to be looking with caution on the question of taking pension funds and investing them in the infrastructure by creating another Government-sponsored enterprise.

This committee has been more active than any committee in the Congress in pointing out that we must stop proliferation of GSEs. We seem to have centered our track on Fannie Mae and Freddie Mac and others, but we know the more you allow those GSEs to be created, the deeper we go into potential liability for the taxpayer. I don't think we ought to pass judgment until we know what is going to be recommended. It is difficult to pass judgment on something we haven't seen much more of than a newspaper rumor.

Those are some of the questions that I think we ought to look at. I don't know how we are going to proceed, but the testimony that you have given today, I think, has been very helpful.

I also think the testimony of Mr. Clarke will show that individuals have been hurt. He is a real live example of a man whose pension, through no fault of his own, has been cut by $700 after he spent 34 years of his life doing excellent work. Something is wrong with that. When that exists, we know that the public will say that is wrong. I think those are some of the problems we have to consider.

I want to say that the testimony you have given us this morning has been factual, honest and straightforward. I don't think it has been frightening, I think it is an honest appraisal and we have to do something about it.

Mr. KLECZKA. One final question before we conclude. We all admit that there is going to be a need for some premium increases. Even though we have done so repeatedly over the years, the problem seems to keep growing. As we look at the unfunded liability for the real serious players, for the companies which have the largest amount, what type of premium increase would you gentlemen recommend? Let's say for instance we are a private insurer instead of with the Government with this implicit or to be an explicit guarantee. What would a private insurance company with their actuarial charts recommend be a justified amount that would naturally be affordable at some point? Would you please respond, gentlemen?

Mr. LOCKHART. I will start off. Coming out of the insurance world maybe I can—for the well-funded plans it may not be very large at all. Many of the well-funded plans may be paying what they should be paying on their insurance premium. On the underfunded plans the premium is much too low. It may be many multiples, 10 times what they are paying would be the fair premium. In some cases these companies are not insurable, would not be insured by the private sector.

A company with a multibillion dollar underfunded plan and very small net worth would not be insurable. If you wanted to use private sector pricing, many of the companies on the top 50 list, we may be talking 5 to 10 times the premium being charged now.

Mr. DELFICO. I agree generally. I suggest this committee look at the cap on the variable premiums to see if raising that cap would provide a hardship to some of the underfunded plans and what kind of a hardship it would be.

Mr. KLECZKA. The question is hardship on the corporation or hardship eventually on the taxpayer.

Mr. DELFICO. There are two questions. I am answering the question raised about companies feeling the stress of higher premiums because they are underfunded and in a distressed situation. The higher premiums may hurt them.

Mr. KLECZKA. But the problem I still have with that, it is these same companies that are increasing their benefits even while they have a large underfunding going on now. So for their generosity we may have to suffer in the future. So I guess we have to consider whether the new level of risk premium will be affordable, but I can't put that as the number one priority because of the other ramifications that would occur.

Mr. REISCHAUER. In the study that we did for the subcommittee, we cite a PBGC study that tried to look at what a private insurer might charge for this kind of insurance based on risk. The study used data from 1985, so the costs are probably considerably higher now than they were at that point. Nevertheless, using the 1985 costs, 11 of the most underfunded firms would have had to pay more than $500 per participant and 2 would have had to pay more than $8,000 per participant in annual premiums. If anything, I would think those numbers have grown over the years.

Mr. KLECZKA. Knowing what we know now and the impending problem with the solvency of the fund, when would you recommend Congress look seriously at doing something about that revenue base, yesterday or today?

Mr. REISCHAUER. Probably about 5 years ago.

Mr. KLECZKA. Let me join the chairman in thanking the panel and Mr. Clarke for appearing today. I think the problem will not go away. The chairman has been working on this for years, with limited success. I think with these hearings and the realization that the problem is getting much worse, I think the Congress will listen to Chairman Pickle and say now is the time; we can't undo what we haven't done 5 years ago, but now is the time to start looking and planning for the future.

Mr. SANTORUM. I have a quick question, a comment and then a request. Dr. Reischauer, I recall testimony by former Director Darman before the Budget Committee last year talking about putting this program and others on an accrual base of accounting and that this would somehow change the deficit numbers. How would it do it and would it solve the problem? Is it a better way of accounting for this kind of program?

Mr. REISCHAUER. There was a great deal of uncertainty about the accrual accounting mechanism that the administration proposed, and we were reluctant, knowing what we know now—that is, our limited state of knowledge—to think that that was an appropriate

shift at this time. It would permit a tremendous amount of leeway on the part of budgeteers in determining the number that actually went into the budget. There are several less radical approaches that point us in the same direction, and they are elaborated in the study that we did for you.

Mr. SANTORUM. So your suggestion is that we don't adopt that method of accounting for this program?

Mr. REISCHAUER. At this time, I do not think we have the data base that would allow an accurate application of that method. But I certainly think we could look at—one of the suggestions we make in our study is to determine annually the increase in the excess of liabilities over assets and put that number each year into the budget as an item that would either require an appropriation by the Congress or trigger an increase in premiums or a reduction in benefits.

Mr. SANTORUM. What we are seeing now is what the chairman stated, which is this plan looks like it is a revenue winner year by year, at least in the last several years. But it is not and we are not recognizing that fact. We should be recognizing that fact, at least in my opinion.

Mr. REISCHAUER. At the simplest level, without getting into the complexity of accrual or present-value accounting, you could simply take the change that PBGC calculates in its deficit—which is not a forward-looking number in a sense but is a change in the current status of the liability that taxpayers might have to assume in the future—and include that number in the budget as an item requiring action or response by the Congress, either though funding in the form of taxes or compensatory actions.

Mr. SANTORUM. Are you recommending that we do something like that?

Mr. REISCHAUER. My office does not make recommendations.

Mr. SANTORUM. Mr. Lockhart, would you recommend that we do something like that?

Mr. LOCKHART. I certainly recommend we adopt accrual accounting. No corporation is allowed to file with the SEC on a cash-flow basis.

Mr. SANTORUM. Would that be part of a reform package that you would recommend be included possibly into Mr. Pickle's bill?

Mr. LOCKHART. Yes. I think it is very appropriate that Government corporations and insurance companies be put on accrual budget accounting.

Mr. DELFICO. We are in favor of accrual accounting but we need time to look at the data bases. We need to work the problem through.

Mr. SANTORUM. Is that because of the inadequacy of the financial statements from the PBGC?

Mr. DELFICO. That is a small part of it. There is a larger budgetary data issue that we need to work through.

Mr. SANTORUM. One thing that you mentioned yesterday when you were here, the idea of management flexibility and that that should be included not only in the PBGC but in a lot of others, and everyone on the committee seemed to agree with that. I would welcome suggestions. No one has made suggestions how to implement that via legislation, but I would ask for your recommendations to

be sent to the chairman so we can provide that flexibility to the management of the PBGC so they can better react to the situations they have to deal with. Thank you.

Chairman PICKLE. We will look into the question of accrual accounting. That is something we want to discuss with the chairman and the full committee. That may be the place for it and primarily what we are interested in this morning is looking at the unfunded level of these pension funds. It is in many areas very unfunded and becoming dangerously so.

I am going to run the risk of backing up for 1 minute more. Mr. Lockhart, you gave an example in your testimony about TWA and you said that they had, if I recall it, an unfunded liability somewhere near a billion dollars.

Mr. LOCKHART. Yes, Mr. Chairman.

Chairman PICKLE. Yet the PBGC made an agreement that they would approve the TWA affair with the understanding that the owner, Mr. Icahn, would pay up to $200 million in benefits over a period of time. Now, that has been done. That has been settled. But you said in your statement that you approved that, the PBGC, after intense pressure. I am asking you, what do you mean by intense pressure?

Mr. LOCKHART. What I meant by intense pressure is obviously when you have a very major corporation with 25,000 people, there is a lots of pressure external and internal about not shutting down the company and putting those people out of work. In this case, unfortunately, it came that close. The settlement from Mr. Icahn was significantly more than $200 million, and there is a $300 million secured note from TWA.. The key thing is that if the settlement works, TWA will be ongoing and there will be no losses. Part of the reason PBGC has to settle these kind of cases, a "least worse" situation, is that the legislation is so unclear that supports PBGC. You could easily, following the LTV judges's example, say that these plans are underfunded by zero and that we have no priorities in bankruptcy. When you have that wide range of zero to $1 billion in claims, it means you have to settle somewhere in between. In this case we hopefully have crafted a settlement in which TWA will survive, and if not, there will be significant recoveries from TWA and Mr. Icahn.

Chairman PICKLE. When you reach the stage of continuing an operation or a plan going under, it is a very difficult question for the PBGC or Congress to say whether we should let it go under and put 25,000 workers out of their jobs or should we try to cut the best deal we can. PBGC cut the best deal that it could. I don't know whether you were right or wrong but I do know the Government in effect lost potential reimbursement of $600 to $800 million, a shortfall. It does keep the company going. We do not have to pay out benefits from PBGC and you have to argue if that is better. But the problem is that once you let any company get into that kind of condition, inevitably you will have to make a decision whether it is better to forgive them and keep the company going. What happened to TWA could happen to any company in the future. What we must do is stop this kind of great underfunding of all these companies' plans, or else every one of them in the future is going to be doing exactly what TWA has done. That ought not to happen. That

is all the more reason we ought to examine these situations very carefully and try to do something positive as quickly, as objectively as we can do it under the circumstances.

Thank you for coming. Your testimony has been very helpful. Thank you very much.

Any other questions from committee members?

The subcommittee will stand adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

AARP

Bringing lifetimes of experience and leadership to serve all generations

February 4, 1993

The Honorable J. J. Pickle
Chairman,
Subcommittee on Oversight
242 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The American Association of Retired Persons commends you for holding hearings on the financial condition and the impact of underfunding in the defined benefit pension system. The Association believes that the financial integrity of the pension benefit guaranty program is an essential part of the retirement security framework. The Pension Benefit Guaranty Corporation (PBGC) must continue to be financially able to complete its mission to provide for the "timely and uninterrupted payment of pension benefits."

BACKGROUND

The PBGC was established under the Employee Retirement Income Security Act (ERISA) to guarantee some portion of benefits under employer-provided defined-benefit pension plans (currently up to $29,250 per year.) This title of ERISA arose out of concern over the failure of individuals to get earned pension benefits in the event a plan terminated with insufficient assets to pay benefits. PBGC is designed to provide a federal pension safety net for federally regulated pension benefits that the employer is unable to pay.

PBGC is an independent wholly owned government corporation. In general, defined benefit plans, the only plans covered by PBGC, are required to be a part of the guarantee program. PBGC is intended to be a self-financing program, with revenue coming from employer-paid premiums (ranging from $19-$72 per participant), the assets of terminated plans and their sponsors, and investment income.

PBGC currently has a positive cash flow, which is expected to continue at least through the end of this century. PBGC's longer-term financial condition, however, is currently worsening. This is largely the result of the termination (and anticipated termination) of a small number of large underfunded plans concentrated in a few industries (steel, auto, airline and tire.) In particular, large and well-publicized underfunded plan terminations, such as in LTV, Pan Am and Eastern, have significantly increased PBGC's exposure.

American Association of Retired Persons 601 E Street, N.W. Washington, D.C. 20049 (202) 434-2277

Lovola W. Burgess President Horace B. Deets Executive Director

While pension underfunding is particularly concentrated in a small sector of the defined benefit plan universe, the system as a whole has generally seen improved funding. From 1977 to 1987 (the latest year for which data from form 5500 is available), the funding status of single employer defined-benefit plans has increased from an average of 85 percent funded to 129 percent funded (computed on a termination basis). Recent surveys have indicated that about 85 percent of plans are fully funded (on a termination basis), a significant increase from a decade ago. Indeed, PBGC recently estimated that the system as a whole had about $400 billion more in assets than liabilities.

CURRENT ISSUES

Congress currently has the opportunity to make long-term deliberative changes in the system, without the threat of imminent crisis, that can ensure the long-term financial condition of the PBGC. The earlier that modifications can be made, the less drastic measures will be needed to ensure a proper course for the PBGC. Several problems must be addressed, and we again applaud you for bringing these issues to the forefront.

Minimum Funding

The minimum funding rules, which were recently improved in 1987 in the Pension Protection Act, may once again need to be revisited. While the long-term impact of changes which significantly tightened funding rules is not yet clear, additional changes may be necessary to better insure retirement benefit promises.

Any changes should have as a goal the improvement of pension funding in the future, as well as the prevention of the deterioration of currently troubled plans. Recognizing that many companies currently in financial difficulty may also have a need for improved funding, it is important to strike the proper balance to ensure continued benefit security without undermining the plan itself.

Some have suggested tying future benefit guarantees to the funding status of the plan at the time the benefit was offered. AARP believes such an approach is fundamentally in conflict with PBGC's purpose of insuring retirement benefit security. Indeed, individuals with similar benefit expectations from two different companies, and even from the same company at different times, will find that the level of the federal guarantee is different. Such an approach would undermine PBGC's safety net role and would cause confusion and inconsistency among participants. AARP would urge you to reject any such approach as inconsistent with the PBGC's mission and unfair to participants.

Bankruptcy Changes

Currently, under ERISA, PBGC's claim against the plan sponsor of an underfunded terminated plan in bankruptcy situations is equal to the full amount of the unfunded benefit liabilities up to thirty percent of the sponsor's (and affiliates) net worth. However, recent bankruptcy court rulings have raised a number of issues as to PBGC's priority claims in bankruptcy. While ERISA gives PBGC some priority claims, such claims are not included in bankruptcy law. This lack of consistency has led to reduced recoveries for PBGC.

While not in this committee's jurisdiction, bankruptcy changes should be considered as part of any package to restore PBGC's financial integrity. Revisions to the Bankruptcy Code will end the current dispute in bankruptcy cases, thereby increasing PBGC's recoveries. Again, a balance must be struck between PBGC's interests and those of other creditors. In particular, retirees as a group often are the largest unsecured creditors due to the promise of retiree health benefits. Any changes to bankruptcy law must adequately reflect that changes to PBGC's recovery levels may directly and adversely impact retirees' claims for other benefits.

Annuity Guarantees

The recent failure of several large insurance companies, particularly Executive Life Insurance Co. of California (ELIC), have underscored a gaping whole in the federal framework protecting defined benefit pensions. Many defined benefit pension plans provide benefits in the form of insurance company annuities, both from ongoing plans and in plan terminations. While PBGC guarantees the benefit when it is provided directly by the pension plan, it is PBGC's current position that it does not guarantee defined benefit pensions provided through an insurance company. This current position is in direct conflict with the position taken by PBGC back in 1981 when it declared such annuities were covered by the PBGC.

The current reversal of position by PBGC puts pension annuitants at risk that is not contemplated by ERISA. By no action of their own, pension annuitants effectively lose the federal protection that existed the moment they first became a part of the pension plan. In the absence of federal protection, annuitants must rely on the variations, gaps and unfunded nature of state insurance guaranty funds. The inadequacy of these state funds was amply demonstrated to Executive Life annuitants. When the state took over ELIC, annuitants saw their benefit levels reduced to seventy percent. The shortfalls experienced by these annuitants have yet to be fully made up.

The problems faced by pension annuitants, particularly in the case of ELIC, is exacerbated by the fact that PBGC played a major role in their plight. The policy of pension terminations for reversions, which PBGC sanctioned (along with the Department of Labor and the IRS), has negatively impacted PBGC in a variety of ways. First, PBGC's premium base was significantly diminished. Second, funding levels for those companies remaining in the system were reduced, putting PBGC at further risk. Lastly, PBGC required that annuities be purchased for pensioners in terminating plans, despite the fact that little, if any, oversight of the insurance carrier existed. The fact that reversions encouraged plans to chose the cheapest (in order to maximize reversions), not safest, annuity carrier led directly to the ELIC fiasco.

In order to close the annuity hole in the federal guaranty system which PBGC itself opened, PBGC must once again guarantee annuities. In order to minimize federal liabilities, standards should be put in place for the purchase of annuities. In addition, the state guarantee framework could be made to operate more efficiently and consistently with PBGC's mandate. Finally, if liability exposure is still deemed to exist, additional PBGC premiums (either one-time or ongoing) could be charged for annuity purchases.

Management Deficiencies

While changes to restore PBGC's financial soundness may be necessary, it is also important that PBGC's management deficiencies be corrected. The General Accounting Office recently reported that weaknesses in PBGC's internal controls and financial systems have undermined PBGC's ability to administer the pension insurance program. GAO has been unable to audit PBGC's financial statements and has been unable to determine the reliability of PBGC's estimated liability for future benefits. Without reliable financial statements, neither PBGC, nor this committee, can effectively monitor and correct PBGC's financial condition.

In particular, GAO has reported that PBGC had not developed and put in place proper documentation and support for its estimating process for future benefit liabilities, nor had PBGC assessed the accuracy of the data used in the estimating technique. PBGC has also had serious problems with its premium collection and reporting systems, and GAO asserts that PBGC management has not paid sufficient attention to premium system improvement initiatives.

Because of these management deficiencies, it will be even more difficult to ascertain a complete picture of the problem which this committee must address. Without this information, crafting a legislative remedy becomes even more problematic.

CONCLUSION

Continued pension plan underfunding places both the PBGC and the individuals that it guarantees at future risk of benefit loss. Changes now will improve PBGC's long term ability to pay benefits when necessary. While funding standards must be revisited, other issues such as bankruptcy changes and management improvements must also be addressed. In addition, pension annuities must be made secure in order to ensure that defined benefit pensions, in whatever form, will be paid in a timely and uninterrupted manner.

The Association looks forward to working with this committee to ensure the long term stability of PBGC, and thus the long-term security of the defined benefit pension promise. If you have further questions or issues you would like to discuss, please have your staff call David Certner of our Federal Affairs office at 202-434-3762.

Again, we commend you for raising the issues surrounding the financial status of the PBGC, and the recognition that it is an important component in the security provided by the federal pension benefit framework.

Sincerely,

John Rother

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National Coordinating Committee for Multiemployer Plans

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TESTIMONY OF ROBERT A. GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

FOR THE HOUSE COMMITTEE ON WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT HEARING TO REVIEW THE IMPACT OF UNDERFUNDED DEFINED BENEFIT PENSION PLANS ON THE FEDERAL DEFICIT, PLAN RETIREES, AND PLAN SPONSORS

February 4, 1993

My name is Robert A. Georgine and I am presenting this testimony in my capacity as Chairman of the National Coordinating Committee for Multiemployer Plans ("NCCMP").

The NCCMP is a nonprofit, tax-exempt organization established after Congress enacted ERISA in 1974. It consists of representatives of approximately 240 pension and welfare plans, or their sponsors. On behalf of its affiliated plans, and the approximately ten million participants and beneficiaries of multiemployer plans generally, the NCCMP is entirely engaged in monitoring the development -- legislative, administrative, and judicial -- of the laws relating to the structuring and administration of multiemployer pension and welfare plans.

I am sure that the Members of this distinguished Subcommittee need not be reminded that the Pension Benefit Guaranty Corporation ("PBGC") operates two separate benefit guaranty programs insuring benefits promised to millions of participants of private defined benefit pension plans. These programs are required under the Employee Retirement Income Security Act of 1974 ("ERISA") to be operated independently. Each has its own PBGC-maintained insurance trust fund. The assets of one trust cannot be used to offset liabilities arising in the other program.

However, recent press reports, including the press release announcing this hearing, would lead even the most careful reader to believe that all defined benefit pension plans have serious financial troubles and impose an extraordinary and dangerous risk to the federal government's pension insurance program. This is not so.

The PBGC's multiemployer plan guarantee program is extremely well funded and is not threatening the PBGC's financial condition. There is no need for additional funding or benefit restrictions. In fact, there is a very real danger that the imposition of additional rules could undermine the health and sound funding of multiemployer plans.

My comments focus on the funding status of multiemployer plans and the PBGC's multiemployer guaranty fund. I also comment briefly on proposals, such as the Pension Funding Improvement Act of 1993 (H.R. 298), to subject multiemployer plans to new funding requirements and the detrimental effect such proposals could have on the multiemployer pension system.

1. Multiemployer Plans Are <u>Extremely Well Funded</u>.

The existing multiemployer plan rules, enacted in the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA"), have been successful in facilitating sound funding in multiemployer plans. MPPAA ensures that employers who withdraw from a multiemployer plan pay their fair share of the plan's liabilities for benefits promised to plan participants. MPPAA was the subject of long and careful negotiation and compromise by representatives of all affected parties -- the plans, their participants, contributing employers and the PBGC. In those situations where a withdrawing employer fails to pay, other employers contributing to the plan take on responsibility for those financial commitments over time.

In the twelve years since MPPAA was enacted, multiemployer plan funding levels have risen dramatically. In fact, the most recent survey by the Segal Company found that in the past decade the percentage of multiemployer plans that are fully funded for vested liabilities has increased from 65 to 79 percent of plans. In addition, the survey found that the ratio of assets to vested benefits in multiemployer plans has steadily increased from 90 percent of plans in 1983 to 97 percent of plans in 1990 and 1991.

The sound funding of these plans is also reflected in the PBGC's multiemployer guaranty program. In a May 1991 report to Congress, "The Financial Condition of the PBGC's Multiemployer Insurance Program," the PBGC stated that its multiemployer plan

insurance fund has a surplus of $133 million, which is "four times the reserves for existing insolvencies and others expected in the near future."

The PBGC benefit guaranty programs are financed by annual premiums paid by plan sponsors. Multiemployer plans pay the PBGC a premium of $2.60 per participant per year. In contrast, the premium required of single employer plan sponsors is at least $19.00 per participant per year and may be as high as $72.00 per participant per year, depending upon the plan's funding status. Recently, the PBGC confirmed that no increase in the multiemployer plan premium would be needed, even while recommending that Congress increase the multiemployer plan benefit guaranty levels to reflect inflation.

The existing multiemployer plan rules are working. MPPAA's carefully designed and long-proven provisions should not be interfered with unnecessarily. Such interference is clearly unnecessary in light of the current financial health of these plans and their PBGC guarantee program.

2. Less Than Full Funding Is Not Necessarily Inconsistent With Financial Health.

Severe underfunding in some defined benefit plans has lead to increased pressure to require all plans to fully fund all promised benefits. However, a plan may be financially sound without being fully funded.

Pension liabilities are typically amortized over a reasonable period of time. This is very much like the common practice of taking out a mortgage to finance purchase of a home. If the annual amount to be paid off is reasonable and affordable, given the plan's contribution stream, it makes no sense to limit participants' benefits to those that can be fully funded immediately.

In multiemployer plans, benefits are typically extremely modest and are not automatically adjusted for inflation. These plans must be amended from time to time to maintain meaningful levels of benefits for participants. It would be wrong to enact further funding limitations that could prevent trustees from making cost-of-living and other benefit improvements necessary to permit retirees to afford basic necessities.

Like all defined benefit plans, multiemployer plans depend on contributions made currently to fund benefits and/or benefit increases for retirees. Especially in the collective bargaining context, amounts contributed to such plans explicitly reduce current wages. Multiemployer plan contribution rates are fixed by collective bargaining agreements that must receive the support of a majority of the active employees. These active employees are more likely to agree to reduce wages to make these pension contributions if they receive benefit increases from time to time. Adopting moderate increases for active employees therefore may be the only way the sponsors of a multiemployer plan can obtain the resources to fund benefit increases for nonactive employees and retirees.

In addition, legislation enacted in 1987 would deny deductions for employer contributions to fully funded multiemployer plans. It would clearly be inconsistent and inequitable to require full funding of these plans and then deny employers deductions for contributions to them. We also note that a plan's funding level can change dramatically from time to time due to changes in interest rates, stock values, etc.

Perhaps most importantly, the continued financial health of multiemployer plans would likely be undermined in the long run by further funding limitations and benefit restrictions that could result in the loss of active participants and their contributing employers. This would shrink the broad contribution base that is essential to the health of these plans.

3. Security Posting Requirements Are Unnecessary With Respect <u>to Multiemployer Benefit Increases</u>.

Internal Revenue Code section 401(a)(29) requires an employer to post security before implementing a single employer plan benefit increase that would reduce the plan's funding to less than 60 percent. The Pension Funding Improvements Act of 1993 (H.R. 298) would impose this requirement with respect to amendments that result in less than 90 percent funding levels in multiemployer, as well as single employer, plans.

There is no need to impose this rule on multiemployer plans. The rule was created in an attempt to shore up the single employer PBGC guarantee program,

which has been plagued by financial difficulties. There is no similar need in the multiemployer plan context.

As noted, the vast majority of multiemployer plans are extremely well funded. However, this provision could be harmful to plans that would otherwise adopt benefit improvements that would increase their funding levels to less than 90 percent.

This rule would not be in the best interest even of the small minority of multiemployer plans that are not close to fully funded. The long-term financial health of such plans can best be achieved by adopting moderate benefit increases from time to time during the period during which plan funding levels are being increased. This two-steps-forward, one-step-back process will achieve adequate funding levels while encouraging active participants to continue to support plan participation.

4. Multiemployer Plan Benefit Decisions Are Best Made by Plan Trustees.

Multiemployer plans, by definition, are maintained pursuant to one or more collective bargaining agreements. The boards of trustees are required by law to be made up 50 percent of union representatives and 50 percent of employer representatives.

The plan's trustees ordinarily design and administer all aspects of the benefit program. They set the eligibility rules, determine benefit levels, etc. Trustees typically determine benefit increases after careful consideration of all factors relevant to their particular fund, including the funded status of the plan, the health of the industry, and the needs of the participants. These trustees are in the best position to determine what, if any, benefit improvements are appropriate in light of the plan's projected contribution stream.

* * *

CONCLUSION

The multiemployer pension plan universe is remarkably stable and therefore presents minimal risk to the PBGC's insurance program. MPPAA is working well and achieving its goal of ensuring sound funding for multiemployer plans, consistent with the interests of plan participants and responsible participating employers. No additional legislation is necessary. I strongly believe that plan trustees should retain their flexibility to make benefits and other decisions in the best interests of their fund and its participants.

Thank you for the opportunity to present this testimony.

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